

THE KEG ROYALTIES INCOME FUND

SECOND QUARTER REPORT

For the three and six months ended June 30, 2018

TO OUR UNITHOLDERS

On behalf of the Board of Trustees, I am pleased to present the results of The Keg Royalties Income Fund (the “Fund”) for the three and six months ended June 30, 2018.

RESULTS

The gross sales reported by the 103 Keg restaurants in the Royalty Pool were \$150,974,000 for the quarter, an increase of \$5,502,000 or 3.8% from the comparable quarter of the prior year. Year to date, gross sales were \$312,937,000, an increase of \$13,405,000 or 4.5%.

Royalty income increased by \$175,000 or 3.0% from \$5,869,000 in the three months ended June 30, 2017 to \$6,044,000 in the three months ended June 30, 2018. Year-to-date, royalty income increased by \$448,000 or 3.7% from \$12,075,000 for the six months ended June 30, 2017 to \$12,523,000 for the six months ended June 30, 2018.

Distributable cash before SIFT tax increased by \$31,000 from \$4,301,000 (37.9 cents/Fund unit) to \$4,332,000 (38.2 cents/Fund unit) for the quarter and by \$228,000 from \$9,077,000 (79.9 cents/Fund unit) to \$9,305,000 (82.0 cents/Fund unit) for the six-month period. Distributable cash available to pay distributions to public unitholders decreased by \$20,000 from \$3,209,000 (28.3 cents/Fund unit) to \$3,189,000 (28.1 cents/Fund unit) for the quarter and increased by \$116,000 from \$6,826,000 (60.1 cents/Fund unit) to \$6,942,000 (61.1 cents/Fund unit) year to date. Distributions of \$3,222,000 (28.4 cents/Fund unit) were paid to Fund unitholders during the second quarter of 2018 as compared with \$3,127,000 (27.5 cents/Fund unit) during the second quarter of 2017. During the first six months of 2018, distributions of \$6,444,000 (56.8 cents/Fund unit) were paid to Fund unitholders (excluding the \$341,000 special distribution declared in the fourth quarter of 2017) versus \$6,253,000 (55.1 cents/Fund unit) during the comparable period of the prior year (excluding the \$341,000 special distribution declared in the fourth quarter of 2016). The payout ratio was 101.0% for the second quarter of the current year and 92.8% year to date.

The Fund remains financially well positioned with cash on hand of \$2,478,000 and a positive working capital balance of \$3,907,000 as at June 30, 2018.

OUTLOOK

In Canada, Restaurants Canada has forecasted sales in the full-service restaurant category, the category in which The Keg operates to increase by an average of 4.1% between 2017 and 2021, or 1.2% on an inflation adjusted basis. In the United States (“US”), the National Restaurant Association (“NRA”) has estimated that sales in the full-service category increased by 2.8% in 2016, and has projected sales to increase by 3.5% in 2017. The NRA has not issued a long-term forecast. Given the close historical relationship between disposable income and foodservice spending, management of Keg Restaurants Ltd. (“KRL”) expects that as economic conditions and consumer sentiment continue to improve in North America, sales for The Keg will also improve, leading it to once again outperform the full-service category with respect to same store sales growth.

COMPETITIVE STRENGTH AND GROWTH

The Keg remains an industry leader in the full-service restaurant category in Canada; a category it has resided in for over 45 years. KRL’s management team remains committed to maintaining and improving the legendary high standards that have come to define the brand throughout North America, including The Keg’s high-quality menu, unmatched hospitality and marketing innovation. KRL has consistently demonstrated its ability to deliver growth in both system sales and same store sales over the long term, providing stability and growth in distributable cash and distributions to the Fund’s unitholders.

Sincerely,



C.C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees
August 14, 2018

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Apr. 1 to Jun. 30, 2018	Apr. 1 to Jun. 30, 2017	Jan. 1 to Jun. 30, 2018	Jan. 1 to Jun. 30, 2017
Restaurants in the Royalty Pool	103	100	103	100
Royalty Pool sales ⁽¹⁾	\$ 150,974	\$ 145,472	\$ 312,937	\$ 299,532
Royalty income ⁽²⁾	\$ 6,044	\$ 5,869	\$ 12,523	\$ 12,075
Interest income ⁽³⁾	1,070	1,067	2,130	2,122
Total income	\$ 7,114	\$ 6,936	\$ 14,653	\$ 14,197
Administrative expenses ⁽⁴⁾	(95)	(98)	(208)	(187)
Interest and financing expenses ⁽⁵⁾	(134)	(108)	(265)	(214)
Operating income	\$ 6,885	\$ 6,730	\$ 14,180	\$ 13,796
Distributions to KRL ⁽⁶⁾	(2,581)	(2,429)	(5,276)	(4,939)
Profit before fair value gain (loss) and income taxes	\$ 4,304	\$ 4,301	\$ 8,904	\$ 8,857
Fair value gain (loss) ⁽⁷⁾	2,620	(8,279)	9,545	(4,717)
Income taxes ⁽⁸⁾	(1,138)	(1,093)	(2,349)	(2,301)
Profit (loss) and comprehensive income (loss)	\$ 5,786	\$ (5,071)	\$ 16,100	\$ 1,839
Distributable cash before SIFT tax ⁽⁹⁾	\$ 4,332	\$ 4,301	\$ 9,305	\$ 9,077
Distributable cash ⁽¹⁰⁾	\$ 3,189	\$ 3,209	\$ 6,942	\$ 6,826
Distributions to Fund unitholders ⁽¹¹⁾	\$ 3,222	\$ 3,127	\$ 6,444	\$ 6,253
Payout Ratio ⁽¹²⁾	101.0%	97.4%	92.8%	91.6%
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.379	\$.379	\$.784	\$.780
Profit (loss) and comprehensive income (loss)	\$.510	\$ (.447)	\$ 1.418	\$.162
Distributable cash before SIFT tax ⁽⁹⁾	\$.382	\$.379	\$.820	\$.799
Distributable cash ⁽¹⁰⁾	\$.281	\$.283	\$.611	\$.601
Distributions to Fund unitholders ⁽¹¹⁾	\$.284	\$.275	\$.568	\$.551
SSSG ⁽¹⁴⁾				
Canada	0.8%	6.1%	1.3%	5.7%
United States	4.1%	5.7%	4.8%	2.9%
Consolidated	0.7%	6.5%	1.2%	5.5%
Restaurants in KRL System ⁽¹⁵⁾				
# Beginning of Period	106	101	106	101
Opened	--	2	--	3
Closed	(1)	(1)	(1)	(2)
# End of Period	<u>105</u>	<u>102</u>	<u>105</u>	<u>102</u>

Notes:

- (1) Royalty Pool sales are the gross sales reported by Keg Restaurants included in the Royalty Pool in any period. As of June 30, 2018, the Royalty Pool includes 103 Keg restaurants, 47 of which are owned and operated by KRL and its subsidiaries, (37 in Canada and 10 in the United States), and 56 Keg restaurants which are owned and operated by Keg franchisees (all of which are in Canada). As of June 30, 2018, two corporate and one franchise restaurant, (all opened subsequent to October 2, 2017), are not yet included in the Royalty Pool, while one permanently closed restaurant remains in the Royalty Pool.
- (2) The Fund, indirectly through the “Partnership”, earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- (3) The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- (4) The Fund, indirectly through the Partnership, incurs administrative expenses and interest on the operating line of credit, to the extent utilized.
- (5) The Fund, indirectly through The Keg Holdings Trust (the “Trust”), incurs interest expense on the \$14.0 million term loan and amortization of deferred financing charges.
- (6) Represents the distributions of the Partnership attributable to KRL during the respective periods on the Class A, entitled Class B, and Class D Partnership units (“Exchangeable units”) and Class C Partnership units held by KRL. The Exchangeable units are exchangeable into Fund units on a one-for-one basis. These distributions are presented as interest expense in the financial statements.
- (7) Fair value gain (loss) is the non-cash decrease or increase in the market value of the Exchangeable units held by KRL during the respective period. Exchangeable units are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, taking into consideration the sale of any Exchangeable units and Additional Entitlements during the same period.
- (8) Income taxes for the three months ended June 30, 2018 include SIFT tax expense of \$1,143,000 (three months ended June 30, 2017 – \$1,092,000) and non-cash deferred tax recovery of \$5,000 (three months ended June 30, 2017 – deferred tax expense of \$1,000). Income taxes for the six months ended June 30, 2018, include SIFT tax expense of \$2,363,000 (six months ended June 30, 2017 – \$2,251,000) and a non-cash deferred tax recovery of \$14,000 (six months ended June 30, 2017 – deferred tax expense of \$50,000).
- (9) Distributable cash before SIFT tax is defined as the periodic cash flows from operating activities as reported in the IFRS condensed consolidated financial statements, including the effects of changes in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL through its ownership of Exchangeable units. Distributable cash before SIFT tax is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.
- (10) Distributable cash is the amount of cash available for distribution to the Fund’s public unitholders and is calculated as distributable cash before SIFT tax, less current year SIFT tax expense. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that distributable cash, both before and after SIFT tax, provides useful information regarding the amount of cash available for distribution to the Fund’s public unitholders.
- (11) Distributions to Fund unitholders include all regular monthly cash distributions paid to Fund unitholders during a period and any special distributions, either declared or paid, to Fund unitholders in the same period.
- (12) Payout ratio is computed as the ratio of aggregate cash distributions paid during the period plus any special distributions declared or paid during the same period (numerator) to the aggregate distributable cash of the period (denominator).
- (13) All per unit amounts are calculated based on the weighted average number of Fund units outstanding, which are those units held by public unitholders during the respective period. The weighted average number of Fund units outstanding for the three months ended June 30, 2018 were 11,353,500 (three months ended June 30, 2017 – 11,353,500), and for the six months ended June 30, 2018 were 11,353,500 (six months ended June 30, 2017 – 11,353,500).
- (14) Same Store Sales Growth (“SSSG”) is the overall increase or decrease in gross sales from Keg restaurants (that operated during the entire period of both the current and the prior year) as compared to gross sales for the same period of the prior year. SSSG is not an IFRS financial measure and does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that SSSG provides useful information regarding the increase or decrease in gross sales for comparable restaurants.
- (15) The number of restaurants included in the Royalty Pool, may differ from the number of restaurants in the KRL system at any time as the periods for which they are reported differ. The number of restaurants added or removed from the Royalty Pool during any period will differ from the number of restaurant openings and closings reported by KRL, as the periods for which they are reported differ as well.
- (16) The interim financial results for all periods presented herein have not been audited.

SUMMARY OF QUARTERLY RESULTS

	Q2	Q1	Q4	Q3
(\$000's except per unit amounts)	2018	2018	2017	2017
Restaurants in the Royalty Pool	103	103	100	100
Royalty Pool sales ⁽¹⁾	\$ 150,974	\$ 161,963	\$ 153,639	\$ 147,798
Royalty income ⁽²⁾	\$ 6,044	\$ 6,479	\$ 6,226	\$ 5,993
Interest income ⁽³⁾	1,070	1,059	1,082	1,080
Total income	\$ 7,114	\$ 7,538	\$ 7,308	\$ 7,073
Administrative expenses ⁽⁴⁾	(95)	(113)	(96)	(96)
Interest and financing expenses ⁽⁵⁾	(134)	(131)	(127)	(124)
Operating income	\$ 6,885	\$ 7,294	\$ 7,085	\$ 6,853
Distributions to KRL ⁽⁶⁾	(2,581)	(2,695)	(2,517)	(2,514)
Profit before fair value gain (loss) and income taxes	\$ 4,304	\$ 4,599	\$ 4,568	\$ 4,339
Fair value gain (loss) ⁽⁷⁾	2,620	6,925	2,013	6,696
Income taxes ⁽⁸⁾	(1,138)	(1,210)	(1,284)	(1,115)
Profit (loss) and comprehensive income (loss)	\$ 5,786	\$ 10,314	\$ 5,297	\$ 9,920
Distributable cash before SIFT taxes ⁽⁹⁾	\$ 4,332	\$ 4,973	\$ 4,023	\$ 4,549
Distributable cash ⁽¹⁰⁾	\$ 3,189	\$ 3,754	\$ 2,860	\$ 3,443
Distributions to Fund unitholders ⁽¹¹⁾	\$ 3,222	\$ 3,222	\$ 3,531	\$ 3,127
Payout Ratio ⁽¹²⁾	101.0%	85.8%	123.5%	90.8%
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.379	\$.405	\$.402	\$.382
Profit (loss) and comprehensive income (loss)	\$.510	\$.908	\$.467	\$.874
Distributable cash before SIFT tax ⁽⁹⁾	\$.382	\$.438	\$.354	\$.401
Distributable cash ⁽¹⁰⁾	\$.281	\$.331	\$.252	\$.303
Distributions to Fund unitholders ⁽¹¹⁾	\$.284	\$.284	\$.311	\$.275
SSSG ⁽¹⁴⁾				
Canada	0.8%	1.6%	5.1%	3.0%
United States	4.1%	5.4%	6.5%	5.2%
Consolidated	0.7%	1.5%	4.8%	2.8%
Restaurants in KRL System ⁽¹⁵⁾				
# Beginning of Period	106	106	103	102
Opened	--	--	3	1
Closed	(1)	--	--	--
# End of Period	<u>105</u>	<u>106</u>	<u>106</u>	<u>103</u>

SUMMARY OF QUARTERLY RESULTS

	Q2	Q1	Q4	Q3
(\$000's except per unit amounts)	2017	2017	2016	2016
Restaurants in the Royalty Pool	100	100	100	100
Royalty Pool sales ⁽¹⁾	<u>\$ 145,472</u>	<u>\$ 154,060</u>	<u>\$ 147,837</u>	<u>\$ 145,525</u>
Royalty income ⁽²⁾	\$ 5,869	6,206	\$ 5,931	\$ 5,827
Interest income ⁽³⁾	1,067	1,055	1,076	1,076
Total income	\$ 6,936	7,261	\$ 7,007	\$ 6,903
Administrative expenses ⁽⁴⁾	(98)	(89)	(98)	(105)
Interest and financing expenses ⁽⁵⁾	(108)	(106)	(108)	(113)
Operating income	\$ 6,730	7,066	\$ 6,801	\$ 6,685
Distributions to KRL ⁽⁶⁾	(2,429)	(2,510)	(2,408)	(2,371)
Profit before fair value gain (loss) and income taxes	\$ 4,301	4,556	\$ 4,393	\$ 4,314
Fair value gain (loss) ⁽⁷⁾	(8,279)	3,562	2,185	(12,411)
Income taxes ⁽⁸⁾	(1,093)	(1,208)	(1,142)	(1,132)
Profit (loss) and comprehensive income (loss)	\$ (5,071)	\$ 6,910	\$ 5,436	\$ (9,229)
Distributable cash before SIFT tax ⁽⁹⁾	<u>\$ 4,301</u>	<u>\$ 4,776</u>	<u>\$ 4,053</u>	<u>\$ 4,211</u>
Distributable cash ⁽¹⁰⁾	<u>\$ 3,209</u>	<u>\$ 3,617</u>	<u>\$ 2,940</u>	<u>\$ 3,114</u>
Distributions to Fund unitholders ⁽¹¹⁾	<u>\$ 3,127</u>	<u>\$ 3,127</u>	<u>\$ 3,468</u>	<u>\$ 3,106</u>
Payout Ratio ⁽¹²⁾	<u>97.4%</u>	<u>86.5%</u>	<u>118.0%</u>	<u>99.7%</u>
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.379	\$.401	\$.387	\$.380
Profit (loss) and comprehensive income (loss)	\$ (.447)	\$.609	\$.479	\$ (.813)
Distributable cash before SIFT tax ⁽⁹⁾	<u>\$.379</u>	<u>\$.421</u>	<u>\$.357</u>	<u>\$.371</u>
Distributable cash ⁽¹⁰⁾	<u>\$.283</u>	<u>\$.319</u>	<u>\$.259</u>	<u>\$.274</u>
Distributions to Fund unitholders ⁽¹¹⁾	<u>\$.275</u>	<u>\$.275</u>	<u>\$.305</u>	<u>\$.274</u>
SSSG ⁽¹⁴⁾				
Canada	6.1%	5.3%	0.2%	2.9%
United States	5.7%	0.5%	(2.0)%	1.2%
Consolidated	6.5%	4.5%	0.0%	2.6%
Restaurants in KRL System ⁽¹⁵⁾				
# Beginning of Period	101	101	100	101
Opened	2	1	1	--
Closed	(1)	(1)	--	(1)
# End of Period	<u>102</u>	<u>101</u>	<u>101</u>	<u>101</u>

SELECTED ANNUAL INFORMATION

(\$000's except per unit amounts)	Jan. 1 to Dec. 31, 2017	Jan. 1 to Dec. 31, 2016	Jan. 1 to Dec. 31, 2015
Restaurants in the Royalty Pool	100	100	102
Royalty Pool sales ⁽¹⁾	\$ 600,969	\$ 576,951	\$ 574,048
Royalty income ⁽²⁾	\$ 24,294	\$ 23,101	\$ 23,251
Interest income ⁽³⁾	4,283	4,279	4,281
Total income	\$ 28,577	\$ 27,380	\$ 27,532
Administrative expenses ⁽⁴⁾	(379)	(384)	(435)
Interest and financing expenses ⁽⁵⁾	(463)	(436)	(519)
Operating income	\$ 27,735	\$ 26,560	\$ 26,578
Distributions to KRL ⁽⁶⁾	(9,969)	(9,485)	(9,491)
Profit before fair value gain (loss) and income taxes	\$ 17,766	\$ 17,075	\$ 17,087
Fair value gain (loss) ⁽⁷⁾	3,991	(11,408)	(1,324)
Income taxes ⁽⁸⁾	(4,700)	(4,399)	(4,527)
Profit (loss) and comprehensive income (loss)	\$ 17,057	\$ 1,268	\$ 11,236
Distributable cash before SIFT tax ⁽⁹⁾	\$ 17,649	\$ 17,127	\$ 16,681
Distributable cash ⁽¹⁰⁾	\$ 13,129	\$ 12,807	\$ 12,296
Distributions to Fund unitholders ⁽¹¹⁾	\$ 12,911	\$ 12,591	\$ 12,160
Payout Ratio ⁽¹²⁾	98.3%	98.3%	98.9%
Per Fund unit information ⁽¹³⁾			
Profit before fair value gain (loss) and income taxes	\$ 1.565	\$ 1.504	\$ 1.505
Profit (loss) and comprehensive income (loss)	\$ 1.502	\$.112	\$.990
Distributable cash before SIFT tax ⁽⁹⁾	\$ 1.554	\$ 1.509	\$ 1.469
Distributable cash ⁽¹⁰⁾	\$ 1.156	\$ 1.128	\$ 1.083
Distributions to Fund unitholders ⁽¹¹⁾	\$ 1.137	\$ 1.109	\$ 1.001
SSSG ⁽¹⁴⁾			
Canada	5.1%	1.3%	6.5%
United States	4.3%	0.7%	7.0%
Consolidated	4.7%	1.5%	8.0%
Restaurants in KRL System ⁽¹⁵⁾			
# Beginning of Period	101	101	107
Opened	7	1	3
Closed	(2)	(1)	(9)
# End of Period	106	101	101
	Dec. 31, 2017	Dec. 31, 2016	Dec. 31, 2015
Total assets	\$ 230,671	\$ 226,468	\$ 227,114
Total liabilities	149,131	149,042	138,316

MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three and Six Months Ended June 30, 2018
As of August 14, 2018**

OVERVIEW

KEY ATTRIBUTES OF THE FUND

The Keg Royalties Income Fund (the "Fund") is a limited purpose, open-ended trust which trades on the Toronto Stock Exchange ("TSX") under the symbol KEG.UN. On May 31, 2002, as part of the Initial Public Offering (the "IPO"), the Fund, through its subsidiary The Keg Rights Limited Partnership (the "Partnership"), purchased The Keg trademarks and other related intellectual property (collectively, the "Keg Rights") from Keg Restaurants Ltd. ("KRL"). The Partnership, in turn, granted KRL an exclusive licence to use the Keg Rights for a term of 99 years pursuant to a licence and royalty agreement, which obligates KRL to make monthly royalty payments to the Partnership equal to 4% of gross sales of Keg restaurants included in a specific royalty pool (the "Royalty Pool").

The key feature of the Fund is that royalty income is based on the top-line, gross sales of Keg restaurants in the Royalty Pool and not on the profitability of either KRL or the Keg restaurants in the Royalty Pool. Moreover, the Fund is not subject to the variability of income or expenses associated with an operating business. The Fund's only expenses are nominal administrative expenses and interest on non-amortizing term debt. Thus, the success of the Fund depends primarily on the ability of KRL to maintain and increase the gross sales of the Keg restaurants in the Royalty Pool.

Increases in gross sales are derived from both same store sales growth from existing restaurants ("SSSG") and from the addition of new Keg restaurants. SSSG is the key driver of growth in royalty income and, since the Fund's expenses are relatively fixed in nature, SSSG results in growth in distributable cash which allows for higher distributions to the Fund's unitholders. KRL has generated SSSG through a combination of increased guest counts and increased guest average cheque. SSSG has been achieved by maintaining operational excellence within each Keg restaurant, innovative marketing and promotional programs, and pricing. Over the past twenty years, the period for which current management has been in control of KRL, SSSG has averaged 3.0% annually, a figure that compares very favourably against the restaurant industry as a whole.

In the event that a Keg restaurant is permanently closed during the year (including the termination of a franchise agreement), KRL will continue to pay the royalty amount for that closed Keg restaurant ("Make-whole Payment") from the date of closure until those sales are replaced with gross sales from new Keg restaurants that are added to the Royalty Pool. The amount of the Make-whole Payment is based on the restaurant's gross sales when it was originally included in the Royalty Pool.

Readers should note that the number of restaurants added to the Royalty Pool each year may differ from the number of restaurant openings and closings reported by KRL on an annual basis, as the periods for which they are reported differ slightly.

On January 23, 2018, Recipe Unlimited Corporation ("RECP") (formerly Cara Operations Limited), KRL and the Fund announced that RECP and KRL agreed to merge pursuant to the terms of a binding letter of intent. On February 22, 2018, this transaction was completed but will not impact the operations of the Fund. The Fund will remain in its current form and will continue to receive royalty payments from Keg restaurants included in the Royalty Pool. There are no changes to the contractual relationships between the Fund, KRL and the Partnership arising out of the completion of the RECP and KRL merger.

THE ROYALTY POOL

Annually, on January 1st, the Royalty Pool is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the preceding calendar year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the “Additional Entitlement”). The Additional Entitlement is determined based on 92.5% of the estimated net royalty revenue added to the Royalty Pool, divided by the yield of the Fund units, divided by the weighted average unit price of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st of each year when the actual full-year performance of the new restaurants is known with certainty.

The total number of Keg restaurants included in the Royalty Pool increased from the 80 Keg restaurants in existence on March 31, 2002, to 100 as of December 31, 2017. Sixty-three new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2016, with annual gross sales of \$320,102,000, were added to the Royalty Pool. Forty-three permanently closed Keg restaurants with annual sales of \$132,368,000 were removed from the Royalty Pool. This resulted in a net increase in Royalty Pool sales of \$187,734,000 annually and KRL receiving a cumulative Additional Entitlement equivalent to 5,933,912 Fund units as of December 31, 2017.

On January 1, 2018, an estimated \$20,159,000 in annual net sales were added to the Royalty Pool. Five new restaurants that opened during the period from October 3, 2016 through October 2, 2017, with estimated gross sales of \$28,250,000 annually, were added to the Royalty Pool. Two permanently closed restaurants with annual sales of \$8,091,000 were removed from the Royalty Pool. The total number of restaurants in the Royalty Pool increased to 103. The pre-tax yield of the Fund units was determined to be 7.54% calculated using a weighted average unit price of \$20.28.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL’s Additional Entitlement will be equivalent to 487,765 Fund units, being 3.15% of the Fund units on a fully diluted basis.

On January 1, 2018, KRL received 80% of this entitlement, representing the equivalent of 390,212 Fund units, being 2.54% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 4,030,068 Fund units, representing 26.20% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted on December 31, 2018, to be effective January 1, 2018, once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2018, it would have the right to exchange its Partnership units for 4,127,621 Fund units, representing 26.66% of the Fund units on a fully diluted basis.

KRL'S INTEREST IN THE FUND

KRL's interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances ("Exchangeable units"). KRL's effective ownership of the Fund and its interest in the earnings of the Partnership has grown from 10.00% at the time of the IPO to 24.28% as of December 31, 2017. The increase in KRL's effective ownership of the Fund is due to the cumulative Additional Entitlement received by KRL equivalent to 5,933,912 Fund units, less 3,200,000 Exchangeable units exchanged by KRL for Fund units and sold through the facilities of the TSX. The sale of the 3,200,000 Fund units increased the number of issued and outstanding Fund units from 8,153,500 at the time of the IPO to 11,353,500 as of February 8, 2011.

On January 1, 2018, KRL became entitled to the initial 80% of the Additional Entitlement for 2018, consisting of 390,212 Exchangeable units, increasing its effective ownership of the Fund to 26.20%. See "Royalty Pool" section.

FAIR VALUE GAIN (LOSS)

Fair value gain (loss) is the non-cash decrease or increase in the market value of the Exchangeable units held by KRL during the respective period. It is a non-cash adjustment and, therefore, does not affect distributable cash. The exchangeable units held by KRL are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, during the same period. The closing market price of a Fund unit at the end of each reporting period is used to determine the fair value of the Exchangeable unit liability, since Exchangeable units are exchangeable into Fund units on a one-for-one basis. If the market price of a Fund unit increases during a period, the financial liability of the Fund also increases, and a non-cash loss is recorded during that period. If the market price of a Fund unit decreases during a period, the financial liability of the Fund also decreases, and a non-cash gain is recorded during that period.

FEDERAL GOVERNMENT TAX ON INCOME FUNDS

On January 1, 2011, legislative changes to the tax treatment of certain income trusts, as a result of the Specified Investment Flow-through Trust tax (the "SIFT tax"), came into effect. Due to these changes, income trusts will not be entitled to deduct distributions of certain types of income for tax purposes, and will therefore be subject to taxation similar to corporations. As a result of this taxation imposed by the Federal Government, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make the SIFT tax payments. See "Distributions to Unitholders". The Fund is subject to tax at a rate of 26% for 2016 and 2017. Effective January 1, 2018, the British Columbia general corporate tax rate increased from 11% to 12%, resulting in the Fund being subject to an income tax rate of 27% for the 2018 and later taxation years.

DISTRIBUTIONS TO UNITHOLDERS

The Fund's objective is to provide consistent monthly distributions to unitholders at the highest sustainable level, and the Trustees of the Fund continue to review distribution levels on an ongoing basis to fulfill that objective. Since the inception of the Fund in May 2002 until December 31, 2016, monthly distributions to unitholders have been increased thirteen times, from the original level of 9.0 cents/Fund unit at the time of the IPO, to 12.4 cents/Fund unit, on a pre-tax basis (9.18 cents/Fund unit on an after-tax basis), an increase of 37.8%. During 2017, monthly distributions to Fund unitholders were increased by 3.1% from 9.18 cents/Fund unit to 9.46 cents/Fund unit commencing with the November 2017 distribution.

In addition, special distributions of 7.0 cents/Fund unit were declared in December 2015, 3.0 cents/Fund unit in December 2016, and 3.0 cents/Fund unit in December 2017. For Fund reporting purposes these special distributions were treated as distributions in the year in which they were declared.

As a result of the SIFT tax that came into effect on January 1, 2011, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make these tax payments. The eligible dividend portion of the Fund's distribution, combined with the return of capital component of the distribution, should provide taxable Canadian individuals with an effective after-tax cash return very closely comparable to the return that existed before the imposition of the SIFT tax.

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the third and third quarters, and four distributions in the fourth quarter. This is done to ensure that the distribution based on the Royalty Pool sales for the month of December (which is paid the following month in January), is recorded in the period in which it was earned for income tax purposes.

The determination to declare and make payable distributions from the Fund are at the discretion of the Board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund unitholders.

Year-to-date distributions paid were as follows:

Period	Payment Date	\$ / Unit	Distributions	
			Total \$	Year-to-Date \$
December 1-31, 2017	January 31, 2018	9.46¢	\$ 1,074,041	\$ 1,074,041
January 1-31, 2018	February 28, 2018	9.46¢	\$ 1,074,041	\$ 2,148,082
February 1-28, 2018	March 30, 2018	9.46¢	\$ 1,074,041	\$ 3,222,123
March 1-31, 2018	April 30, 2018	9.46¢	\$ 1,074,041	\$ 4,296,164
April 1-30, 2018	May 31, 2018	9.46¢	\$ 1,074,041	\$ 5,370,205
May 1-31, 2018	June 29, 2018	9.46¢	\$ 1,074,041	\$ 6,444,246
June 1-30, 2018	July 31, 2018	9.46¢	\$ 1,074,041*	\$ 7,518,287*

*Paid subsequent to the period.

Distributions paid during the period were funded entirely by cash flow from operations and no debt was incurred at any point during the year to fund distributions.

A special distribution of \$341,000 (3.0 cents/Fund unit) which was declared in December 2017 and paid January 31, 2018 was treated as a distribution in 2017 for Fund reporting purposes.

Since inception, the Fund has generated \$180,282,000 of distributable cash, and paid cumulative distributions of \$178,488,000, which has resulted in a cumulative surplus of \$1,794,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid plus any special distributions declared since inception, to the cumulative distributable cash generated since inception) is 99.0%.

DISTRIBUTABLE CASH

Distributable cash is defined as the periodic cash flows from operating activities as reported in the condensed consolidated financial statements, including the change in non-cash working capital balances, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL, less current year SIFT tax expense. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.

Distributable cash is calculated as follows:

(\$000's)	Apr. 1 to Jun. 30, <u>2018</u>	Apr. 1 to Jun. 30, <u>2017</u>	Jan. 1 to Jun. 30, <u>2018</u>	Jan 1 to Jun. 30, <u>2017</u>
Cash flow from operations ⁽¹⁾	\$ 5,902	\$ 5,754	\$ 12,409	\$ 12,050
SIFT tax paid on Fund units ⁽²⁾	1,140	1,078	2,425	2,173
Interest and financing fees paid on term loan ⁽³⁾	(129)	(102)	(253)	(207)
KRL's interest ⁽⁴⁾	<u>(2,581)</u>	<u>(2,429)</u>	<u>(5,276)</u>	<u>(4,939)</u>
Distributable cash before current year SIFT tax	\$ 4,332	\$ 4,301	\$ 9,305	\$ 9,077
SIFT tax expense on Fund units ⁽⁵⁾	<u>(1,143)</u>	<u>(1,092)</u>	<u>(2,363)</u>	<u>(2,251)</u>
Distributable cash ⁽⁶⁾	<u>\$ 3,189</u>	<u>\$ 3,209</u>	<u>\$ 6,942</u>	<u>\$ 6,826</u>

Notes:

- ⁽¹⁾ Represents the cash flow from operations as reported in the condensed consolidated statements of cash flows.
- ⁽²⁾ Includes SIFT taxes actually paid during the respective period. During the second quarter of 2018, \$1,140,000 was paid, all on account for 2018 (second quarter of 2017 – \$1,078,000). During the first six months of 2018, \$2,425,000 was paid, consisting of \$2,238,000 on account of 2018, and \$187,000 on account of 2017 (first six months of 2017 – \$2,173,000, all on account of 2017).
- ⁽³⁾ Represents the interest and financing fees paid on the term loan.
- ⁽⁴⁾ Represents the distributions of the Partnership attributable to KRL during the respective periods on the Exchangeable and Class C units held by KRL. The distributions attributable to KRL will differ from the actual distributions paid to KRL during the same periods, due to the timing of the declaration of distributions.
- ⁽⁵⁾ Represents the SIFT tax expense for the respective period calculated at 27% of estimated taxable income for 2018 and 26% for 2017.
- ⁽⁶⁾ Distributable cash is the amount of cash available for distribution to the Fund's public unitholders. It is defined as the periodic cash flows from operating activities as reported in the IFRS condensed consolidated financial statements, including the change in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL, and less current year SIFT tax expense.

OWNERSHIP OF THE FUND

The ownership of the Fund on a fully diluted basis is as follows:

	June 30, 2018 ⁽¹⁾		June 30, 2017 ⁽¹⁾	
	#	%	#	%
Fund units held by public unitholders ⁽²⁾	11,353,500	73.80	11,353,500	75.93
Exchangeable Partnership units held by KRL: ⁽³⁾				
Class A units ⁽⁴⁾	905,944	5.89	905,944	6.06
Class B units ⁽⁵⁾	176,700	1.15	176,700	1.18
Class D units ⁽⁵⁾	<u>2,947,424</u>	<u>19.16</u>	<u>2,517,170</u>	<u>16.83</u>
Total Exchangeable Partnership units ⁽⁶⁾	<u>4,030,068</u>	<u>26.20</u>	<u>3,599,814</u>	<u>24.07</u>
Total Fund and Exchangeable Partnership units	<u>15,383,568</u>	<u>100.00</u>	<u>14,953,314</u>	<u>100.00</u>

Notes:

- ⁽¹⁾ Information is current as of June 30, 2018. On December 31, 2017, but effective January 1, 2017, KRL became entitled to the remaining balance of the Additional Entitlement for 2017 consisting of 40,042 Exchangeable units, increasing its effective ownership of the fund to 24.28% on a fully diluted basis. On January 1, 2018, KRL became entitled to the initial 80% of the Additional Entitlement for 2018, consisting of 390,212 Exchangeable units, increasing its effective ownership of the Fund to 26.20%. As of June 30, 2018, there are 11,353,500 Fund units outstanding, and 4,030,068 Exchangeable Partnership units issued and outstanding, all of which are entitled to distributions.
- ⁽²⁾ Represents the public's total effective ownership of the Fund as of June 30, 2018 and June 30, 2017. The public's average effective ownership of the Fund (based on the weighted average number of Fund units held by public unitholders during the respective period) was 73.80% during the three and six months ended June 30, 2018 (three and six months ended June 30, 2017 – 75.93%). The weighted average number of Fund units outstanding for the three and six months ended June 30, 2018 was 11,353,500 (three and six months ended June 30, 2017 – 11,353,500).
- ⁽³⁾ Exchangeable into Fund units on a one-for-one basis.
- ⁽⁴⁾ Represents KRL's initial 10% effective ownership of the Fund, prior to the entitlement of Class B or Class D units.
- ⁽⁵⁾ These Exchangeable Partnership units are issued to KRL in return for adding net sales to the Royalty Pool on an annual basis. Class D units are equivalent to Class B units in all material respects but began to be issued once all Class B units became fully entitled to distributions on January 1, 2008. As of June 30, 2018, KRL is the registered holder of 176,700 Class B units and 2,947,424 Class D units, all of which are entitled (June 30, 2017 – 176,700 Class B units and 2,517,170 Class D units, all of which were entitled). Also included in these figures is 80% of the Additional Entitlement estimated at the beginning of each calendar year, pursuant to which KRL receives a proportionate increase in monthly distributions from the Partnership. The remaining 20% of KRL's Additional Entitlement of Class B and Class D units is adjusted retroactively to January 1st of each year once the actual sales performance of the new restaurants has been confirmed. KRL is not entitled to proportionate monthly distributions from the Partnership on the remaining 20% of KRL's Additional Entitlement until such time as the Additional Entitlement is adjusted retroactively at the end of each calendar year.
- ⁽⁶⁾ Represents KRL's total effective ownership of the Fund as of June 30, 2018 and June 30, 2017. KRL's average effective ownership of the Fund (based on the weighted average number of Exchangeable units held by KRL during the respective period) was 26.20% during the three and six months ended June 30, 2018 (three and six months ended June 30, 2017 – 24.07%). The weighted average number of Exchangeable units held by KRL during the three and six months ended June 30, 2018 was 4,030,068 (three and six month period ended June 30, 2017 – 3,599,814).

SYSTEM SALES

While the Fund's income is indirectly based on a royalty of 4% of sales of Keg restaurants in the Royalty Pool, the total system sales of The Keg chain are of interest to the Fund and its unitholders as the total system sales best reflect the chain's overall performance. The following table sets out The Keg's total system sales for the periods indicated below:

(\$000's)	13 weeks ended Jul. 1, <u>2018</u>	13 weeks ended Jul. 2, <u>2017</u>	26 weeks ended Jul. 1, <u>2018</u>	26 weeks ended Jul. 2, <u>2017</u>
Corporate Keg restaurants ⁽¹⁾	\$ 79,419	\$ 73,245	\$ 163,414	\$ 147,638
Franchised Keg restaurants ⁽²⁾	<u>76,070</u>	<u>77,314</u>	<u>158,929</u>	<u>159,405</u>
Total system sales	<u>\$ 155,489</u>	<u>\$ 150,559</u>	<u>\$ 322,343</u>	<u>\$ 307,043</u>

SECOND QUARTER

System sales for the 13 weeks ended July 1, 2018 were \$155,489,000 compared to \$150,559,000 for the 13 weeks ended July 2, 2017, an increase of \$4,930,000 or 3.3%. The increase was due to the net impact of the same store sales increases at comparable restaurants during the quarter (\$1,476,000 increase in sales), the negative effect of the exchange rate decline on the translation of the US restaurant sales into their Canadian dollar equivalent (\$508,000 decrease in sales), the sales of the new restaurants that operated during the comparable quarter (\$5,667,000 increase in sales), the sales of restaurants temporarily closed for renovation during KRL's 13-week period ended July 2, 2017 (\$1,343,000 increase in sales), the loss of sales of restaurants temporarily closed for renovation during KRL's 13-week period ended July 1, 2018 (\$2,257,000 decrease in sales), and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter (\$791,000 decrease in sales).

During the 13 weeks ended July 1, 2018, no new restaurants were opened, and one corporate restaurant in Canada was permanently closed, due to a lease expiry. During the 13 weeks ended July 2, 2017, one corporate and one franchise restaurant were opened, and one corporate restaurant was permanently closed due to a lease expiry, all in Canada. As of July 1, 2018, there were a total of 105 Keg restaurants as compared with 102 Keg restaurants at July 2, 2017.

Same store sales (sales of restaurants that operated during the entire 13-week periods of both the current and prior years) increased by 0.8% in Canada and by 4.1% in the US. After translating the sales of the US restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week periods increased by 0.7%. The average exchange rate moved from 1.3450 in KRL's 13-week period ended July 2, 2017 to 1.2923 in KRL's 13-week period ended July 1, 2018, significantly reducing the Canadian dollar equivalent of the US restaurant sales.

YEAR TO DATE

System sales for the 26 weeks ended July 1, 2018 were \$322,343,000 compared to \$307,043,000 for the 26 weeks ended July 2, 2017, an increase of \$15,300,000 or 5.0%. The increase was due to the net impact of the same store sales increases at comparable restaurants during the period (\$4,790,000 increase in sales), the negative effect of the exchange rate decrease on the translation of the US restaurant sales into their Canadian dollar equivalent (\$1,145,000 decrease in sales), the sales of the new restaurants that operated during the comparable period (\$14,948,000 increase in sales), the sales of restaurants temporarily closed for renovation during KRL's 26-week period ended July 2, 2017 (\$1,209,000 increase in sales), the loss of sales from restaurants temporarily closed for renovation during KRL's 26-week period ended July 1, 2018 (\$2,708,000 decrease in sales), and the loss of sales from permanently closed restaurants that did not operate during the comparable period (\$1,794,000 decrease in sales).

YEAR TO DATE (CONTINUED)

During the 26 weeks ended July 1, 2018, no restaurants were opened, and one corporate restaurant in Canada was permanently closed due to a lease expiry. During the 26 weeks ended July 2, 2017 one corporate and two franchise restaurants were opened, one franchise restaurant was relocated, and one corporate restaurant was permanently closed due to a lease expiry, all in Canada.

Same store sales (sales of restaurants that operated during the entire 26-week period of both the current year and prior years) increased by 1.3% in Canada and by 4.8% in the US. After translating the sales of the US restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 26-week periods increased by 1.2%. The average exchange rate moved from 1.3341 in KRL's 26-week period ended July 2, 2017, to 1.2779 in KRL's 26-week period ended July 1, 2018, significantly reducing the Canadian dollar equivalent of the US restaurant sales.

OPERATING RESULTS

SECOND QUARTER

ROYALTY POOL SALES

Royalty Pool sales increased by \$5,502,000 from \$145,472,000 to \$150,974,000 for the comparable quarter. The increase in Royalty Pool sales was due to the net impact of same store sales increases at comparable Royalty Pool restaurants during the comparable quarter (\$1,476,000 increase in Royalty Pool sales), the negative effect of the exchange rate decrease on the translation of the US restaurant sales into their Canadian dollar equivalent (\$526,000 decrease in Royalty Pool sales), the sales of new restaurants added to the Royalty Pool on January 1, 2018 (\$6,257,000 increase in Royalty Pool sales), the sales of restaurants temporarily closed for renovation during the comparable quarter of the prior year (\$1,343,000 increase in Royalty Pool sales), the loss of sales of restaurants temporarily closed for renovation during the comparable quarter of the current year (\$2,257,000 decrease in Royalty Pool sales), and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter of the current year (\$791,000 decrease in Royalty Pool sales).

ROYALTY INCOME

Total royalty income increased from \$5,869,000 in the second quarter of 2017 to \$6,044,000 in the second quarter of 2018. The increase of \$175,000 during the comparable quarter consists of an increase in royalty fee income of \$220,000, and a decrease in Make-whole fees of \$45,000.

The increase in royalty fee income was due to the net impact of same store sales increases at comparable Royalty Pool restaurants during the comparable quarter (\$59,000 increase in royalty fee income), the negative effect of the exchange rate decrease on the translation of US restaurant sales into their Canadian dollar equivalent (\$21,000 decrease in royalty fee income), the sales of new restaurants added to the Royalty Pool on January 1, 2018 (\$250,000 increase in royalty fee income), the sales of restaurants temporarily closed for renovation during the comparable quarter of the prior year, (\$54,000 increase in royalty fee income), the loss of sales of restaurants temporarily closed for renovation during the comparable quarter of the current year (\$90,000 decrease in royalty fee income), and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter of the current year (\$32,000 decrease in royalty fee income).

Make-whole fees decreased as fewer restaurants were closed during the comparable quarter. During the second quarter of the current year, one restaurant was subject to Make-whole payments (that restaurant was closed for a total of 2 weeks during the comparable quarter), whereas in the comparable quarter of the prior year, two restaurants were subject to Make-whole payments (those restaurants were closed for a total of 14 weeks during the comparable quarter).

INTEREST INCOME

Interest income earned by the Fund during the second quarter of the current year was \$1,070,000 and was comprised of interest income on the Keg Loan of \$1,066,000 and other interest income of \$4,000. Interest income on the Keg Loan remained the same during the comparable quarter, while other interest income earned by the Fund on surplus cash balances increased by \$3,000. Interest income earned on cash balances increased as higher interest rates were applied to the cash balances on hand during the comparable quarter.

ADMINISTRATIVE EXPENSES

Expenses incurred by the Partnership for the quarter ended June 30, 2018 were \$95,000, comprised entirely of general and administrative expenses. General and administrative expenses decreased by \$3,000 from the comparable quarter of the prior year, due to the timing of certain expenses.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$134,000 for the three months ended June 30, 2018, and included interest on the long-term debt of \$129,000, and amortization of deferred financing charges of \$5,000. The increase in interest and financing expenses of \$26,000, was entirely due to an increase in the interest expense on the long-term debt during the comparable quarter. Interest expense on the long-term debt increased, as the effective interest rate on that debt increased from 2.95% to 3.70% as a result of three changes to the prime lending rate in the past year.

OPERATING INCOME

The Fund's operating income increased from \$6,730,000 during the second quarter of 2017, to \$6,885,000 during the second quarter of 2018. The increase of \$155,000 was due to the net impact of the increase in royalty income of \$175,000, the increase in interest income of \$3,000, the decrease in administrative expenses of \$3,000 and the increase in interest and financing expenses of \$26,000.

DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the three months ended June 30, 2018 were \$2,581,000, which included distributions of \$1,512,000 on the Exchangeable units and \$1,069,000 on the Class C units. Distributions on the Exchangeable units increased by \$152,000 from the comparable quarter of the prior year, due to the combined impact of an increase in the operating income of the Fund during the second quarter of the current year, and an increase in KRL's average effective ownership of the Fund during that period. KRL's average effective ownership of the Fund increased from 24.07% during the second quarter of 2017 to 26.20% during the second quarter of 2018, primarily as a result of the initial 80% of the Additional Entitlement received by KRL on January 1, 2018 from the roll-in of sales of net new restaurants on that date. The distributions declared on the Class C units remained the same during the comparable periods, which were \$0.0625 per Class C unit per month.

PROFIT BEFORE FAIR VALUE GAIN (LOSS) AND INCOME TAXES

Profit before fair value gain (loss) and income taxes increased by \$3,000 from a profit of \$4,301,000 (37.9 cents/Fund unit) in the second quarter of 2017, to a profit of \$4,304,000 (37.9 cents/Fund unit) in the second quarter of 2018.

FAIR VALUE GAIN (LOSS)

The fair value of the Exchangeable unit liability decreased by \$2,620,000 during the three months ended June 30, 2018, as compared with an increase of \$8,279,000 during the three months ended June 30, 2017.

During the three months ended June 30, 2018, the fair value of the 4,030,068 Exchangeable units held by KRL during that entire quarter decreased, as the closing market price of a Fund unit (the basis upon which the Exchangeable units held by KRL are valued) decreased from \$18.30 to \$17.65, resulting in a non-cash gain to the Fund of \$2,620,000.

During the comparable quarter of the prior year, the fair value of the 3,599,814 Exchangeable units held by KRL during that entire period increased, as the closing market price of a Fund unit increased from \$20.10 to \$22.40, resulting in a non-cash loss to the Fund of \$8,279,000.

INCOME TAXES

Income taxes for the three-month period ended June 30, 2018, were \$1,138,000, and included SIFT tax expense of \$1,143,000 and a non-cash deferred income tax recovery of \$5,000. Income taxes increased by \$45,000 due to the net impact of an increase in SIFT taxes of \$51,000 and a decrease in deferred taxes of \$6,000. SIFT tax expense increased due to the combined impact of an increase in the SIFT tax rate from 26% to 27%, effective January 1, 2018, and an increase in the taxable income of the Fund during the comparable quarter. The deferred income tax expense decreased during the comparable quarter, due to changes in the temporary differences between the accounting and tax basis of the Keg Rights owned by the Partnership.

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Profit (loss) increased by \$10,857,000 from a loss of \$5,071,000 (-44.7 cents/Fund unit) in the second quarter of 2017, to a profit of \$5,786,000 (51.0 cents/Fund unit) in the second quarter of 2018, mainly due to the change in the non-cash fair value adjustment of the Exchangeable unit liability.

DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by \$31,000 from \$4,301,000 (37.9 cents/Fund unit) to \$4,332,000 (38.2 cents/Fund unit) during the comparable quarter. Cash available for distribution to Fund unitholders decreased by \$20,000 from \$3,209,000 (28.3 cents/Fund unit) to \$3,189,000 (28.1 cents/Fund unit) during the comparable quarter. The difference between the Fund's profit (loss) and distributable cash is due to non-cash items such as amortization, fair value gain (loss), and deferred income taxes included in the Fund's profit (loss), as well as changes in non-cash working capital balances.

DISTRIBUTIONS TO FUND UNITHOLDERS

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters and four distributions in the fourth quarter. This is done to ensure that the distribution based on the Royalty Pool sales for the month of December (which is paid the following month in January) is recorded in the period in which it was earned for income tax purposes.

In the second quarter of 2018, distributions to Fund unitholders included regular cash distributions paid of \$3,222,000 (28.4 cents/Fund unit), whereas in the second quarter of 2017 distributions to Fund unitholders included regular cash distributions paid of \$3,127,000 (27.5 cents/Fund unit). The total increase of \$95,000 in cash distributions paid during the comparable quarters was the result of monthly distributions having been increased during the fourth quarter of 2017.

YEAR TO DATE

ROYALTY POOL SALES

Royalty Pool sales increased by \$13,405,000 from \$299,532,000 to \$312,937,000 for the comparable six-month period. The increase in gross sales was due to the net impact of the same store sales increases at comparable Royalty Pool restaurants during the period (\$4,789,000 increase in Royalty Pool sales), the negative effect of the exchange rate decrease on the translation of the US restaurant sales into their Canadian dollar equivalent (\$1,150,000 decrease in Royalty Pool sales), the sales of new restaurants added to the Royalty Pool on January 1, 2018 (\$13,059,000 increase in Royalty Pool sales), the sales of restaurants temporarily closed for renovation during the comparable period of the prior year (\$1,209,000 increase in Royalty Pool sales), the loss of sales from restaurants temporarily closed for renovation during the comparable period of the current year (\$2,708,000 decrease in Royalty Pool sales), and the loss of sales from permanently closed restaurants that did not operate during the period (\$1,794,000 decrease in Royalty Pool sales).

ROYALTY INCOME

Total royalty income increased from \$12,075,000 in the first six months of 2017 to \$12,523,000 in the first six months of 2018. The increase of \$448,000 during the comparable period consists of an increase in royalty fee income of \$537,000, and a decrease in Make-whole fees of \$89,000.

The increase in royalty fee income was due to the net impact of same store sales increases at comparable Royalty Pool restaurants during the period (\$192,000 increase in royalty fee income), the negative effect of the exchange rate decrease on the translation of US restaurant sales into their Canadian dollar equivalent (\$45,000 decrease in royalty fee income), the sales of the new restaurants added to the Royalty Pool on January 1, 2018 (\$522,000 increase in royalty fee income), the sales of restaurants temporarily closed for renovation during the comparable period of the prior year (\$48,000 increase in royalty fee income), the loss of sales from restaurants temporarily closed for renovation during the comparable period of the current year (\$108,000 decrease in royalty fee income), and the loss of sales from permanently closed restaurants that did not operate during the period (\$72,000 decrease in royalty fee income).

Make-whole fees decreased as fewer restaurants were closed during the comparable period. During the first six months of the current fiscal year, one restaurant was subject to Make-whole payments (that restaurant was closed for a total of 2 weeks during the comparable period), whereas in the comparable period of the prior fiscal year, two restaurants were subject to Make-whole payments (those restaurants were closed for a total of 26 weeks).

INTEREST INCOME

Interest income earned by the Fund during the six-month period of the current year was \$2,130,000, and was comprised of interest income on the Keg Loan of \$2,120,000 and other interest income of \$10,000. Interest income on the Keg Loan remained the same during the comparable period, while other interest income earned by the Fund on cash balances increased by \$10,000. Interest income earned on cash balances increased as higher interest rates were applied to the cash balances on hand during the comparable period.

ADMINISTRATIVE EXPENSES

Expenses incurred by the Partnership for the six months ended June 30, 2018 were \$208,000, comprised entirely of general and administrative expenses. General and administrative expenses increased by \$21,000 from the comparable quarter of the prior year, primarily as a result of fees paid to the TSX for listing the incremental exchangeable Class D units that were issued on January 1, 2018, but also, due to the timing of certain expenses.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$265,000 for the six months ended June 30, 2018, and included interest on the long-term debt of \$255,000, and amortization of deferred financing charges of \$10,000. The increase in interest and financing expenses of \$51,000, was due to a \$50,000 increase in interest expense on the long-term debt, and a \$1,000 increase in amortization of deferred finance charges during the comparable quarter. Interest expense on the long-term debt increased, as the effective interest rate on that debt increased from 2.95% to 3.68%, as a result of three changes to the prime lending rate in the past year.

OPERATING INCOME

The Fund's operating income increased from \$13,796,000 during the first half of 2017, to \$14,180,000 during the first half of 2018. The increase of \$384,000 is due to the net impact of the increase in royalty income of \$448,000, the increase in interest income of \$8,000, the increase in administrative expenses of \$21,000, and the increase in interest and financing expenses of \$51,000.

DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the six months ended June 30, 2018 were \$5,276,000, which included distributions of \$3,138,000 on the Exchangeable units and \$2,138,000 on the Class C units. Distributions on the Exchangeable units increased by \$337,000 from the comparable six-month period of the prior year, due to the combination of an increase in the operating income of the Fund during the first six months of 2018, and an increase in KRL's average effective ownership of the Fund during that period. KRL's average effective ownership of the Fund increased from 24.07% during the first half of 2017 to 26.20% during the first half of 2018, primarily as a result of the initial 80% of the Additional Entitlement received by KRL on January 1, 2018, from the roll-in of sales of net new restaurants on that date. The distributions declared on the Class C units remained the same during the comparable periods, which were \$0.0625 per Class C unit per month.

PROFIT BEFORE FAIR VALUE GAIN (LOSS) AND INCOME TAXES

Profit before fair value gain (loss) and income taxes increased by \$47,000 from \$8,857,000 (78.0 cents/Fund unit) in the first six months of 2017, to \$8,904,000 (78.4 cents/Fund unit) in the first six months of 2018.

FAIR VALUE GAIN (LOSS)

The fair value of the Exchangeable unit liability decreased by \$9,545,000 during the six months ended June 30, 2018, as compared with an increase of \$4,717,000 during the six months ended June 30, 2017.

During the six months ended June 30, 2018, the fair value of the 3,639,856 Exchangeable units held by KRL during that entire period decreased, as the closing market price of a Fund unit (the basis upon which the Exchangeable units held by KRL are valued) decreased from \$19.99 to \$17.65, resulting in a non-cash gain to the Fund of \$8,517,000. In addition, the fair value of the 390,212 Exchangeable units granted to KRL on January 1, 2018 (as the initial 80% of the Additional Entitlement for 2018), decreased from \$20.28 (the roll-in price) to \$17.65, resulting in a further non-cash gain to the Fund of \$1,028,000.

During the six months ended June 30, 2017, the fair value of the 3,468,091 Exchangeable units held by KRL during that entire period increased, as the closing market price of a Fund unit (the basis upon which the Exchangeable units held by KRL are valued) increased from \$21.10 to \$22.40, resulting in a non-cash loss to the Fund of \$4,509,000. In addition, the fair value of the 131,723 Exchangeable units granted to KRL on January 1, 2017, as the initial 80% of the Additional Entitlement for 2017, increased from \$20.82 (the roll-in price) to \$22.40, resulting in a further non-cash loss to the Fund of \$208,000.

INCOME TAXES

Income taxes for the six-month period ended June 30, 2018, were \$2,349,000, and included SIFT tax expense of \$2,363,000 and a non-cash deferred income tax recovery of \$14,000. Income taxes increased by \$48,000 due to the net impact of an increase in SIFT taxes of \$112,000 and a decrease in deferred taxes of \$64,000. SIFT tax expense increased due to the combined impact of an increase in the SIFT tax rate from 26% to 27%, effective January 1, 2018, and an increase in the taxable income of the Fund during the comparable six-month period. The deferred income tax expense decreased during the comparable quarter, due to changes in the temporary differences between the accounting and tax basis of the Keg Rights owned by the Partnership.

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Profit increased by \$14,261,000 from a profit of \$1,839,000 (16.2 cents/Fund unit) during the six months ended June 30, 2017 to a profit of \$16,100,000 (\$1.418/Fund unit) during the comparable period of 2018, mostly due to the change in the non-cash fair value gain (loss) of the Exchangeable unit liability.

DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by \$228,000 from \$9,077,000 (79.9 cents/Fund unit) to \$9,305,000 (82.0 cents/Fund unit) during the comparable period. Cash available for distribution to Fund unitholders increased by \$116,000 from \$6,826,000 (60.1 cents/Fund unit) to \$6,942,000 (61.1 cents/Fund unit) during the comparable period. The difference between the Fund's earnings and distributable cash is due to non-cash items such as amortization, fair value gain (loss), and deferred income taxes included in the Fund's net earnings, as well as changes in non-cash working capital balances.

DISTRIBUTIONS TO FUND UNITHOLDERS

Distributions of \$6,253,000 (55.1 cents/Fund unit) were paid to Fund unitholders during the first half of 2017 as compared with \$6,444,000 (56.8 cents/Fund unit) during the first half of 2018. The increase of \$191,000 in cash distributions paid during the comparable period was the result of monthly distributions having been increased during the fourth quarter of 2017.

LIQUIDITY & CAPITAL RESOURCES

It is the Fund's policy to distribute all available cash on a monthly basis in order to provide consistent returns to unitholders and to maximize those returns. Any increase in distributions in the future will be implemented in such a manner so as to maintain uniform monthly distributions.

The special distribution declared in December 2017, which was paid on January 31, 2018, was treated as a distribution in 2017 for Fund reporting purposes.

During the second quarter of 2018, the Fund generated \$3,189,000 in distributable cash, and paid distributions of \$3,222,000 to public unitholders, resulting in a deficit of \$33,000. Year-to-date, the Fund generated \$6,942,000 in distributable cash and paid distributions of \$6,444,000 to public unitholders, resulting in a surplus of \$498,000.

TERM LOAN

The Trust has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 0.25% per annum. The facility was originally arranged during the IPO to partially finance the purchase of the Keg Rights from KRL, and to provide term debt as part of the capital structure. On September 15, 2017, the Fund amended the terms of this loan with its existing banking syndicate and extended the maturity date to July 2, 2020. The term loan held by the Trust is subject to certain financial covenants, including minimum equity amounts in both the Trust and the Partnership, and a minimum Partnership cash flow level defined as profit (loss) before interest, fair value gain (loss), taxes, depreciation and amortization (“EBITDA”). As at June 30, 2018, the Trust and Partnership are in compliance with all financial covenants associated with this facility.

OPERATING LINE OF CREDIT

The Partnership, a subsidiary of the Fund, has a \$1 million operating line of credit, which bears interest at bank prime plus 0.25% per annum. This facility is used primarily to bridge timing differences between the receipt of the royalty payments and distributions on the Partnership securities. This operating line is also available for general working capital purposes or, if required, to help finance periodic differences between receipt of the royalty payment (which may vary due to small seasonal variations in the gross sales of those restaurants in the Royalty Pool), and distributions to unitholders. As at June 30, 2018, the entire \$1 million facility is available for use.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of The Keg GP Ltd., managing general partner of the Partnership and administrator to the Fund, have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS and applicable securities legislation.

The control framework used to design the internal controls over financial reporting is “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in 2013. There have been no significant changes to the internal control over financial reporting for the quarter ended June 30, 2018 that have had or are reasonably likely to have a material effect on the Fund’s internal controls over financial reporting.

It should be noted that a control system, including the Fund’s disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Fund’s consolidated financial statements in conformity with IFRS requires estimates and judgements to be made that affect the reported amounts of assets and liabilities, income and expenses, and related disclosures. These estimates are based on historical experience and knowledge of economics, market factors and the restaurant industry along with various other assumptions that are believed to be reasonable under the circumstances.

The Fund believes that the following selected accounting policies are critical to understanding the estimates, assumptions and uncertainties that affect the amounts reported and disclosed in the Fund’s consolidated financial statements and related notes.

CONSOLIDATION

Applying the criteria outlined in IFRS 10, “*Consolidated Financial Statements*”, judgement is required in determining whether the Fund controls the Partnership. Making this judgement involves taking into consideration the concept of power over the Partnership, exposure to variable returns, and the ability to use power to direct the relevant activities of the Partnership so as to generate economic returns. Using these criteria, management has determined that the Fund ultimately controls the Partnership through its 90% ownership of the managing general partner, The Keg GP Ltd.

KEG RIGHTS

The Fund carries the Keg Rights at historical cost comprising the amount of consideration paid for the Keg Rights in 2002 as part of the Fund’s IPO, as well as the value of additional sales of net new Keg restaurants added to the Royalty Pool since inception. The value of the gross sales of new Keg restaurants added to the Royalty Pool is determined on a formula basis that is designed to estimate the present value of the cash flows due to the Fund as a result of the sales of these new Keg restaurants being added to the Royalty Pool. As such, the calculation is dependent on a number of variables including the estimated long-term sales of the new Keg restaurants and a discount rate. The value assigned to the sales of net new Keg restaurants, and as a result, the value assigned to the Keg Rights, could differ from actual results.

The Fund tests the Keg Rights for impairment annually, which requires that the Fund use a valuation technique to determine if impairment exists. This valuation technique may not represent the actual fair value less costs to sell that the Fund expects the Keg Rights to generate.

EXCHANGEABLE UNIT FAIR VALUE GAIN (LOSS)

The Fund is required under IFRS to classify the Exchangeable units as a financial liability at fair value. This requires that the Fund uses a valuation technique to determine the fair value of the Exchangeable units at the applicable reporting dates. The Fund estimates the fair value of this financial liability using the Fund’s market capitalization at the end of the applicable period and allocating KRL’s entitlement based upon its percentage ownership of the Fund on a fully-diluted basis as at June 30, 2018.

As at June 30, 2018, the closing price of a Fund unit was \$17.65 resulting in a market capitalization of \$271.5 million. KRL’s 26.20% ownership of the Fund (on a fully-diluted basis) was calculated to be \$71.1 million. This valuation technique may not represent the actual value of the financial liability should such Exchangeable units be extinguished, and changes in the distribution rate on the Exchangeable units and the yield of the Fund’s units could materially impact the Fund’s financial position and results of operations.

DEFERRED INCOME TAX EXPENSE

The Fund uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred income tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of such changes.

The determination of deferred income taxes requires the use of judgement and estimates. If certain judgements or estimates prove to be inaccurate, or if certain tax rates or laws change, the Fund’s results of operations and financial position could be materially impacted.

NEW ACCOUNTING STANDARDS

Effective January 1, 2018, the Fund has adopted IFRS 9, *Financial Instruments* (“IFRS 9”) and IFRS 15, *Revenue from Contracts with Customers* (“IFRS 15”).

IFRS 9

On July 24, 2014, the International Accounting Standards Board (“IASB”) issued IFRS 9, *Financial Instruments* and subsequently published amendments. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions.

IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

Classification and measurement of financial assets and financial liabilities:

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans, and receivables and available for sale.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost; fair value in OCI (“FVOCI”) – debt investment; or fair value in profit or loss. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. Financial liabilities are classified and measured on two categories: amortized costs or fair value through profit or loss (“FVTPL”). Derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

The following table and the accompanying notes below explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Fund’s financial assets and liabilities. The adoption of the new classification requirements under IFRS 9 did not result in any changes in measurement or the carrying amount of financial assets and liabilities.

<u>Financial Asset / Liability</u>	<u>Classification under IAS 39</u>	<u>Classification under IFRS 9</u>
Cash	Loans and receivables	Amortized cost
Royalty fee receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Interest on note receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Note receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Interest payable on term loan	Other financial liabilities	Amortized cost
Distributions payable to Fund unitholders	Other financial liabilities	Amortized cost
Distributions payable to Keg Restaurants Ltd.	Other financial liabilities	Amortized cost
Term loan, net of deferred financing charges	Other financial liabilities	Amortized cost
Class C partnership units	Other financial liabilities	Amortized cost
<u>Exchangeable Partnership units</u>	<u>FVTPL</u>	<u>FVTPL</u>

NEW ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 (CONTINUED)

Impairment of financial assets:

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ (“ECL”) model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Under IFRS 9 credit losses are recognized earlier than under IAS 39.

Financial assets measured at amortized cost are assessed at each reporting date to determine the credit risk of the financial asset to apply the relevant impairment requirements. There are generally 3 stages of credit risk:

1. Financial assets that are expected to perform in line with their contractual terms and which have no signs of increased credit risk;
2. Financial assets that have significantly increased in credit risk since initial recognition but are not credit-impaired; and
3. Credit-impaired financial instruments.

A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Fund on terms that the Fund would not consider otherwise, or indications that a debtor or issuer will enter bankruptcy.

The Fund considers evidence of impairment of financial assets measured at amortized cost at both a specific asset and collective level. All individually significant financial assets measured at amortized cost are assessed for specific impairment. All individually significant financial assets measured at amortized cost found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Such assets that are not individually significant are collectively assessed for impairment by grouping together financial assets measured at amortized cost with similar risk characteristics.

An impairment loss in respect of a financial asset measured at amortized cost is measured through a loss allowance at an amount equal to:

- 12-month expected credit losses (ECLs): these are ECLs that result from possible default events within the 12 months after the reporting date; and
- Lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

Losses are recognized in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through comprehensive income.

Derivative financial instruments:

The requirement of the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative financial instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

Aside from classification, the impact of adopting IFRS 9 has had no material impact on measurement of the Fund’s financial assets and liabilities.

NEW ACCOUNTING STANDARDS (CONTINUED)

IFRS 15

On May 28, 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*. IFRS 15 replaces IAS 18, *Revenue* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services. This is achieved by applying the following five steps:

1. identify the contract with a customer;
2. identify the performance obligations in the contract;
3. determine the transaction price;
4. allocate the transaction price to the performance obligations in the contract; and
5. recognize revenue when (or as) the entity satisfies a performance obligation.

Revenue recognition under a lease commences when the tenant has a right to use the leased assets. Generally, this occurs on the lease inception date or, when the Fund is required to make additions to the property in the form of tenant improvements which enhances the value of the property, when substantially complete. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease. A straight-line rent receivable is included in the carrying amount.

There was no significant impact on the Fund's financial statements or business as a result of the adoption of this new standard.

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

IFRS 16

On January 13, 2016, the IASB issued IFRS 16, *Leases*, which supersedes IAS 17, *Leases*. IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases. The standard establishes a single model for lessees to bring leases on-balance sheet while lessor accounting remains largely unchanged and retains the finance and operating lease distinctions. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted but only if also applying IFRS 15, *Revenue from Contracts with Customers*. The Fund is currently in the preliminary stages of evaluating the impact of IFRS 16 but does not anticipate any significant impact on its financial statements or business as a result of the adoption of this new standard during its fiscal year beginning on January 1, 2019.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash and cash equivalents, royalty fee receivable from KRL, interest on note receivable from KRL, note receivable from KRL, accounts payable and accrued liabilities, interest payable on the term loan, distributions payable to Fund unitholders, distributions payable to KRL, Class C Partnership unit liability and the term loan. The requirement for the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined that there is no significant value applicable to this feature.

FINANCIAL INSTRUMENTS (CONTINUED)

The fair values of the amount due from KRL, accounts payable and accrued liabilities, interest payable on the term loan and the distributions payable to Fund unitholders approximate their carrying amounts, largely due to the short-term maturities of these instruments. The fair value of the note receivable from KRL and the Class C unit liability approximate their carrying values due to the requirement of the Fund to settle the note receivable from KRL in exchange for Class C Partnership units equal to \$10.00 per Class C unit transferred. The fair value of the term loan is not materially different from its carrying value as the variable rate of interest on the facility would not be significantly different from the current market rate of interest due to the considerable security held by the banking syndicate.

OUTLOOK

In Canada, Restaurants Canada has estimated that sales in the full-service restaurant category, the category in which The Keg operates, increased by 6.0% in 2016 and has projected sales to increase by 5.5% in 2017. Restaurants Canada has also forecasted sales in the full-service category to increase by an average of 4.1% per year between 2017 and 2021 (1.2% per year on an inflation adjusted basis). In the US, the National Restaurant Association has estimated that sales in the full-service category increased by 2.8% in 2016, and has projected sales to increase by 3.5% in 2017. The NRA has not yet released a long-term forecast. Given the close historical relationship between disposable income and foodservice spending, management of KRL expects that as economic conditions continue to improve in North America, so will sales in the full-service category of the restaurant industry.

While management of KRL does not expect a significant improvement in economic conditions in the near term, management believes that The Keg will continue to outperform the full-service restaurant category with respect to same store sales growth. Management of KRL continues to monitor the global economy and evaluate its potential impact on the North American business environment, particularly the effect on consumer confidence and discretionary spending. Management of KRL has advised the Trustees that it intends to continue to focus on growing same store sales and to continue to expand the number of corporate and franchised restaurants in Canada and the US.

KRL management has also advised the Trustees that it believes that the strong same store sales growth KRL has delivered in the past will continue to be realized over the long term through a combination of increased guest counts and increased guest average cheque. Advertising and promotions programs will continue to focus on food taste, quality and excellent service in a friendly atmosphere.

Management of KRL has further advised the Trustees that it believes that continued Canadian market expansion will be leveraged by KRL's leading market position and national presence.

Corporate market expansion in the US will continue to focus on two target markets, specifically: Phoenix, Arizona; and Dallas, Texas. KRL management has advised the Trustees that it intends to continue to pursue franchising opportunities in the US.

KRL continues to refurbish, and in some cases, relocate existing Keg restaurants in order to better serve its guests and to protect and enhance the strong leadership position The Keg brand has enjoyed for over forty-five years. KRL has opened two corporate and one franchise restaurant since October 2, 2017, and these restaurants will be added to the Royalty Pool on January 1, 2019.

Management of KRL expects to open one additional corporate and one additional franchise restaurant prior to October 2, 2018. The scheduled opening of these new restaurants remains conditional upon the timely receipt of municipal approvals, construction permits, and ongoing evaluation of the current economic environment.

RISKS AND UNCERTAINTIES

The Fund continues to recognize certain risks and uncertainties associated with the ordinary course of business, including those associated with the business and operations of KRL, upon which the Fund relies solely for its income.

THE RESTAURANT INDUSTRY

The performance of the Fund is directly dependent upon the royalty and interest payments received from KRL. The amount of the royalty is dependent upon restaurant sales, which is subject to a number of factors that affect the restaurant industry generally and the casual dining segment of the industry in particular. The casual dining segment of the restaurant industry is intensely competitive with respect to price, service, location and food quality. There are many well-established competitors, particularly in the US, with substantially greater financial and other resources than KRL. Competitors include national and regional chains, as well as individually owned restaurants.

THE RESTAURANT INDUSTRY (CONTINUED)

Recently, competition has increased in the mid-price, full-service, casual dining segment in which Keg restaurants operate. If KRL and The Keg franchisees are unable to successfully compete in the casual dining segment of the restaurant industry, sales may be adversely affected, the amount of the royalty reduced and the ability of KRL to pay the royalty or interest on the Keg Loan may be impaired. The restaurant business is also affected by changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants.

In addition, factors such as inflation; increased food; labour and benefits costs; government regulations; smoking by-laws; and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general and therefore potentially KRL and its franchisees. Changing consumer preferences, discretionary spending patterns and factors affecting the availability of beef could force KRL to modify its restaurant content and menu, and could result in a reduction of restaurant sales. Accordingly, this could impact the amount of the royalty and financial condition of KRL.

Consumer preferences could be affected by health concerns about the consumption of beef, the primary item served at Keg restaurants, and specific events such as the outbreak of “mad cow disease” could reduce the available supply of beef or significantly raise the price of beef.

KRL’s success also depends on numerous factors affecting discretionary consumer spending including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce restaurant sales and operating income, which could adversely affect the royalty and the ability of KRL to pay the royalty, the Make-whole payment or interest on the Keg Loan.

AVAILABILITY AND QUALITY OF RAW MATERIALS

Management of KRL continues to monitor any cases of mad cow disease found in North America. The continued widespread testing of herds confirms that these were isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has not been any significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite previous border closures. Management of KRL expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FLUCTUATIONS IN FOREIGN EXCHANGE RATES

As at June 30, 2018, KRL has 10 restaurants located in the US, all of which are corporately owned through its wholly owned subsidiaries. Keg restaurants located in the US generate sales in US dollars, which must be translated into their Canadian dollar equivalent for Fund reporting purposes. Fluctuations in foreign exchange rates will affect the Canadian dollar equivalent of the sales of the restaurants located in the US, which will affect the amount of the royalty.

FORWARD LOOKING INFORMATION

Certain information included in this report contains forward-looking statements within the meaning of applicable securities laws. These statements include, but are not limited to, statements made in the Overview, Outlook, Competitive Strength and Growth, The Royalty Pool, Distributions to Unitholders, and Critical Accounting Estimates sections and other statements concerning the Fund's business plans and objectives, activities and management's beliefs, plans, estimates and intentions, and similar statements concerning the Fund's anticipated future events, results, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "would", "expect", "intend", "estimate", "anticipate", "believe", "should", "plan", "continue", or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. All forward-looking statements in this Management's Discussion and Analysis are qualified by these cautionary statements.

These forward looking statements are not guarantees of future events or performance and, by their nature, are based on the Fund's current estimates and assumptions, which are subject to risks and uncertainties, including those described in this Management's Discussion and Analysis, which could cause actual events or results to differ materially from the forward looking statements made in this Management's Discussion and Analysis. Those risks and uncertainties include, but are not limited to:

- changes in national and local business and economic conditions that may affect competition in the restaurant industry, changes in demographic trends, or changes in consumer preferences and discretionary spending patterns;
- availability and quality of raw materials;
- growth of the royalty fee and the impact on the royalty amount from the closure of Keg restaurants;
- the ability of franchisees' to generate sales and pay franchise fees and other amounts;
- dependence on key personnel;
- maintenance of strong intellectual property and brand equity;
- unexpected costs or liabilities related to changes in regulations governing alcoholic beverages, income or sales tax legislation, environmental matters or food-borne illnesses; and
- fluctuations in the foreign exchange rate between the Canadian and US dollar.

The foregoing list of factors is not exhaustive and should be considered in conjunction with the risks and uncertainties set out in KRL's Management's Discussion and Analysis for the 52 weeks ended October 1, 2017, which are available on SEDAR at www.sedar.com.

Material assumptions or factors that were applied in drawing a conclusion or making an estimate set out in the forward looking information may include, but are not limited to:

- a stable pace of real estate development opportunities;
- absence of material changes in law;
- protection of the Keg Rights;
- continued access to financing by each of KRL and its franchisees;
- no unexpected closings of Keg restaurants that will have a material adverse affect on the royalty amount; and
- expectations related to future general economic conditions.

Although the forward looking information contained in this Management's Discussion and Analysis is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward looking statements. The forward-looking information contained in this document is current only as of the date of this document and reflects current expectations regarding future events and operating performance. Except as required by law, the Fund undertakes no obligation to publicly update, supplement or revise any forward looking statement, whether as a result of new information, changing circumstances, future events or otherwise. Certain statements included in this Management's Discussion and Analysis may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this Management's Discussion and Analysis.

ADDITIONAL INFORMATION

Additional information about the Fund including the Fund's most recent annual information form is available on SEDAR at www.sedar.com.

UNITHOLDER INFORMATION

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BOARD OF TRUSTEES

C. C. Woodward
George Killy
Tim Kerr

BOARD OF DIRECTORS AND OFFICERS OF THE KEG GP LTD., THE GENERAL PARTNER OF THE KEG RIGHTS LIMITED PARTNERSHIP

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Secretary, Treasurer and Director
George Killy*
Director
Tim Kerr*
Director

* Audit Committee and Governance Committee Member

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING

Toronto Stock Exchange: KEG.UN

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The Keg Royalties Income Fund Announces Second Quarter 2018 Results

Not for distribution to U.S. News wire services or dissemination in the U.S.

Vancouver – August 14, 2018 – The Keg Royalties Income Fund (the “Fund”) (TSX: KEG.UN) is pleased to announce its financial results for the three and six months ended June 30, 2018.

The gross sales reported by the 103 Keg restaurants in the Royalty Pool were \$150,974,000 for the quarter, an increase of \$5,502,000 or 3.8% from the comparable quarter of the prior year. Year-to-date gross sales increased by \$13,405,000 or 4.5% to \$312,937,000. The increase in Royalty Pool sales during the quarter and year-to-date, reflect the sales of the new Keg restaurants added to the Royalty Pool on January 1, 2018, and same store sales increases of 0.7% for the quarter and 1.2% year to date.

The Keg’s same store sales (sales of restaurants that operated during the entire period of both the current and prior years) increased by 0.8% in Canada and by 4.1% in the United States (“U.S.”) for the 13-week period ended July 1, 2018. For the 26-week period ended July 1, 2018, same store sales increased by 1.3% in Canada and by 4.8% in the U.S. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales increased by 0.7% for the 13-week period and by 1.2% for the 26-week period. The average exchange rate moved from 1.3450 to 1.2923 in the comparable 13-week period, and from 1.3341 to 1.2779 in the comparable 26-week period, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales in the comparable periods.

Royalty income increased by \$175,000 or 3.0% from \$5,869,000 in the three months ended June 30, 2017 to \$6,044,000 in the three months ended June 30, 2018. For the six months ended June 30, 2018 royalty income increased by \$448,000 or 3.7% from \$12,075,000 to \$12,523,000.

Distributable cash before SIFT tax increased by \$31,000 from \$4,301,000 (37.9 cents/Fund unit) to \$4,332,000 (38.2 cents/Fund unit) for the quarter and by \$228,000 from \$9,077,000 (79.9 cents/Fund unit) to \$9,305,000 (82.0 cents/Fund unit) for the six-month period. Distributable cash available to pay distributions to public unitholders decreased by \$20,000 from \$3,209,000 (28.3 cents/Fund unit) to \$3,189,000 (28.1 cents/Fund unit) for the quarter and increased by \$116,000 from \$6,826,000 (60.1 cents/Fund unit) to \$6,942,000 (61.1 cents/Fund unit) year to date. The Fund’s payout ratio was 101.0% for the second quarter of 2018 and 92.8% year to date.

The Fund remains financially well-positioned with cash on hand of \$2,478,000 and a positive working capital balance of \$3,907,000 as at June 30, 2018.

“The Keg once again generated same store sales increases and the Fund enjoyed another positive quarter,” said David Aisenstat, President and CEO of Keg Restaurants Ltd. “There are some headwinds in the restaurant industry in many of the provinces, but despite this our brand continues to attract our loyal guests.”

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Apr. 1 to Jun. 30, 2018	Apr. 1 to Jun. 30, 2017	Jan. 1 to Jun. 30, 2018	Jan. 1 to Jun. 30, 2017
Restaurants in the Royalty Pool	103	100	103	100
Royalty Pool sales ⁽¹⁾	\$ 150,974	\$ 145,472	\$ 312,937	\$ 299,532
Royalty income ⁽²⁾	\$ 6,044	\$ 5,869	\$ 12,523	\$ 12,075
Interest income ⁽³⁾	1,070	1,067	2,130	2,122
Total income	\$ 7,114	\$ 6,936	\$ 14,653	\$ 14,197
Administrative expenses ⁽⁴⁾	(95)	(98)	(208)	(187)
Interest and financing expenses ⁽⁵⁾	(134)	(108)	(265)	(214)
Operating income	\$ 6,885	\$ 6,730	\$ 14,180	\$ 13,796
Distributions to KRL ⁽⁶⁾	(2,581)	(2,429)	(5,276)	(4,939)
Profit before fair value gain (loss) and income taxes	\$ 4,304	\$ 4,301	\$ 8,904	\$ 8,857
Fair value gain (loss) ⁽⁷⁾	2,620	(8,279)	9,545	(4,717)
Income taxes ⁽⁸⁾	(1,138)	(1,093)	(2,349)	(2,301)
Profit (loss) and comprehensive income (loss)	\$ 5,786	\$ (5,071)	\$ 16,100	\$ 1,839
Distributable cash before SIFT tax ⁽⁹⁾	\$ 4,332	\$ 4,301	\$ 9,305	\$ 9,077
Distributable cash ⁽¹⁰⁾	\$ 3,189	\$ 3,209	\$ 6,942	\$ 6,826
Distributions to Fund unitholders ⁽¹¹⁾	\$ 3,222	\$ 3,127	\$ 6,444	\$ 6,253
Payout Ratio ⁽¹²⁾	101.0%	97.4%	92.8%	91.6%
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.379	\$.379	\$.784	\$.780
Profit (loss) and comprehensive income (loss)	\$.510	\$ (.447)	\$ 1.418	\$.162
Distributable cash before SIFT tax ⁽⁹⁾	\$.382	\$.379	\$.820	\$.799
Distributable cash ⁽¹⁰⁾	\$.281	\$.283	\$.611	\$.601
Distributions to Fund unitholders ⁽¹¹⁾	\$.284	\$.275	\$.568	\$.551

Notes:

- (1) Royalty Pool sales are the gross sales reported by Keg Restaurants included in the Royalty Pool in any period. As of June 30, 2018, the Royalty Pool includes 103 Keg restaurants, 47 of which are owned and operated by KRL and its subsidiaries (37 in Canada and 10 in the United States), and 56 Keg restaurants which are owned and operated by Keg franchisees (all of which are in Canada). As of June 30, 2017, two corporate and one franchise restaurant (all opened subsequent to October 2, 2017), are not yet included in the Royalty Pool, while one permanently closed restaurant remains in the Royalty Pool.
- (2) The Fund, indirectly through the "Partnership", earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- (3) The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- (4) The Fund, indirectly through the Partnership, incurs administrative expenses and interest on the operating line of credit, to the extent utilized.
- (5) The Fund, indirectly through The Keg Holdings Trust (the "Trust"), incurs interest expense on the \$14.0 million term loan and amortization of deferred financing charges.

- (6) Represents the distributions of the Partnership attributable to KRL during the respective periods on the Class A, entitled Class B, and Class D Partnership units ("Exchangeable units") and Class C Partnership units held by KRL. The Exchangeable units are exchangeable into Fund units on a one-for-one basis. These distributions are presented as interest expense in the financial statements.
- (7) Fair value gain (loss) is the non-cash decrease or increase in the market value of the Exchangeable units held by KRL during the respective period. Exchangeable units are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, taking into consideration the sale of any Exchangeable units and Additional Entitlements during the same period.
- (8) Income taxes for the three months ended June 30, 2018 include SIFT tax expense of \$1,143,000 (three months ended June 30, 2017 – \$1,092,000) and non-cash deferred tax recovery of \$5,000 (three months ended June 30, 2017 – deferred tax expense of \$1,000). Income taxes for the six months ended June 30, 2018, include SIFT tax expense of \$2,363,000 (six months ended June 30, 2017 – \$2,251,000) and a non-cash deferred tax recovery of \$14,000 (six months ended June 30, 2017 – deferred tax expense of \$50,000).
- (9) Distributable cash before SIFT tax is defined as the periodic cash flows from operating activities as reported in the IFRS condensed consolidated financial statements, including the effects of changes in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL through its ownership of Exchangeable units. Distributable cash before SIFT tax is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.
- (10) Distributable cash is the amount of cash available for distribution to the Fund's public unitholders and is calculated as distributable cash before SIFT tax, less current year SIFT tax expense. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that distributable cash, both before and after SIFT tax, provides useful information regarding the amount of cash available for distribution to the Fund's public unitholders.
- (11) Distributions to Fund unitholders include all regular monthly cash distributions paid to Fund unitholders during a period and any special distributions, either declared or paid, to Fund unitholders in the same period.
- (12) Payout ratio is computed as the ratio of aggregate cash distributions paid during the period plus any special distributions declared or paid during the same period (numerator) to the aggregate distributable cash of the period (denominator).
- (13) All per unit amounts are calculated based on the weighted average number of Fund units outstanding, which are those units held by public unitholders during the respective period. The weighted average number of Fund units outstanding for the three months ended June 30, 2018 were 11,353,500 (three months ended June 30, 2017 – 11,353,500), and for the six months ended June 30, 2018 were 11,353,500 (six months ended June 30, 2017 – 11,353,500).

The Fund (TSX: KEG.UN) is a limited purpose, open-ended trust established under the laws of the Province of Ontario that, through The Keg Rights Limited Partnership, owns certain trademarks and other related intellectual property used by Keg Restaurants Ltd. ("KRL"). In exchange for use of those trademarks, KRL pays the Fund a royalty of 4% of gross sales of Keg restaurants included in the royalty pool.

Vancouver-based KRL is the leading operator and franchisor of steakhouse restaurants in Canada and has a substantial presence in select regional markets in the United States. KRL continues to operate The Keg restaurant system and expand that system through the addition of both corporate and franchised Keg steakhouses. KRL has been named one of the "50 Best Employers in Canada" for the past fifteen years by Aon Hewitt. For more information on our brand, visit www.kegsteakhouse.com.

This press release may contain certain "forward looking" statements reflecting The Keg Royalties Income Fund's current expectations in the casual dining segment of the restaurant food industry. Investors are cautioned that all forward looking statements involve risks and uncertainties, including those relating to the Keg's ability to continue to realize historical same store sales growth, changes in market and existing competition, new competitive developments, and potential downturns in economic conditions generally. Additional information on these and other potential factors that could affect the Fund's financial results are detailed in documents filed from time to time with the provincial securities commissions in Canada.

This press release shall not constitute an offer to sell or the solicitation of an offer to buy, which may be made only by means of the prospectus, nor shall there be any sale of the Fund units in any state, province or other jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any state, province or jurisdiction. The Keg Royalties Income Fund units have not been, and will not be registered under the U.S. Securities Act of 1933, as amended and may not be offered or sold in the United States absent registration or an application for exemption from the registration requirement under U.S. securities laws.

The Trustees of the Fund have approved the contents of this press release.

For further information:

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THE KEG ROYALTIES INCOME FUND

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the three and six months ended June 30, 2018 and 2017

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	Note	June 30, 2018 (unaudited)	December 31, 2017
ASSETS			
Current assets:			
Cash		\$ 2,478	\$ 2,490
Prepaid expenses and deposits		43	9
Royalty fee receivable from Keg Restaurants Ltd.	9	2,478	2,863
Interest on note receivable from Keg Restaurants Ltd.	9	351	363
Current income tax receivable	8	-	-
		5,350	5,725
Note receivable from Keg Restaurants Ltd.		57,000	57,000
Intangible assets, Keg Rights	5	175,861	167,946
		\$ 238,211	\$ 230,671
LIABILITIES AND UNITHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities		\$ 333	\$ 307
Interest payable on term loan		43	41
Distributions payable to Fund unitholders		-	1,415
Distributions payable to Keg Restaurants Ltd.	9	951	1,058
Current income tax payable	8	116	178
		1,443	2,999
Term loan, net of deferred financing charges		13,957	13,947
Deferred income taxes	8	2,410	2,424
Class C Partnership units		57,000	57,000
Exchangeable Partnership units	7	71,131	72,761
Unitholders' equity:			
Fund units		123,275	123,275
Accumulated deficit		(31,005)	(41,735)
		92,270	81,540
		\$ 238,211	\$ 230,671

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Approved on behalf of the Board of Trustees

“C.C. Woodward”
C.C. Woodward, Trustee

“George Killy”
George Killy, Trustee

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME(LOSS)

(Expressed in thousands of dollars, except unit and per unit amounts - unaudited)

	<u>Note</u>	April 1 to June 30, 2018	April 1 to June 30, 2017	January 1 to June 30, 2018	January 1 to June 30, 2017
Revenue:					
Royalty income	4	\$ 6,044	\$ 5,869	\$ 12,523	\$ 12,075
Interest income		<u>1,070</u>	<u>1,067</u>	<u>2,130</u>	<u>2,122</u>
		7,114	6,936	14,653	14,197
Expenses:					
General and administrative		(95)	(98)	(208)	(187)
Interest and financing fees		(129)	(103)	(255)	(205)
Amortization of deferred financing charges		<u>(5)</u>	<u>(5)</u>	<u>(10)</u>	<u>(9)</u>
		<u>(229)</u>	<u>(206)</u>	<u>(473)</u>	<u>(401)</u>
Profit before distributions, fair value gain (loss) and income taxes		6,885	6,730	14,180	13,796
Distributions recorded as interest:					
Class C Partnership units		(1,069)	(1,069)	(2,138)	(2,138)
Exchangeable Partnership units		<u>(1,512)</u>	<u>(1,360)</u>	<u>(3,138)</u>	<u>(2,801)</u>
		<u>(2,581)</u>	<u>(2,429)</u>	<u>(5,276)</u>	<u>(4,939)</u>
Profit before fair value gain (loss) and income taxes ...		4,304	4,301	8,904	8,857
Fair value gain (loss) on Exchangeable Partnership units	7	<u>2,620</u>	<u>(8,279)</u>	<u>9,545</u>	<u>(4,717)</u>
Profit (loss) before income taxes		6,924	(3,978)	18,449	4,140
Income tax recovery (expense):					
Current	8	(1,143)	(1,092)	(2,363)	(2,251)
Deferred	8	<u>5</u>	<u>(1)</u>	<u>14</u>	<u>(50)</u>
		<u>(1,138)</u>	<u>(1,093)</u>	<u>(2,349)</u>	<u>(2,301)</u>
Profit and comprehensive income (loss) for the period...		<u>\$ 5,786</u>	<u>\$ (5,071)</u>	<u>\$ 16,100</u>	<u>\$ 1,839</u>
Weighted average Fund units outstanding	3	<u>11,353,500</u>	<u>11,353,500</u>	<u>11,353,500</u>	<u>11,353,500</u>
Weighted average diluted units outstanding	3	<u>15,383,568</u>	<u>14,953,314</u>	<u>15,383,568</u>	<u>14,953,314</u>
Basic earnings (loss) per Fund unit	3	<u>\$ 0.51</u>	<u>\$ (0.45)</u>	<u>\$ 1.42</u>	<u>\$ 0.16</u>
Diluted earnings (loss) per Fund unit	3	<u>\$ 0.28</u>	<u>\$ (0.45)</u>	<u>\$ 0.58</u>	<u>\$ 0.16</u>

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN UNITHOLDERS' EQUITY

(Expressed in thousands of dollars - unaudited)

	<u>Note</u>	<u>Fund units</u>	<u>Accumulated deficit</u>	<u>Unitholders' equity</u>
Balance, January 1, 2017		\$ 123,275	\$ (45,849)	\$ 77,426
Profit and comprehensive income for the period		-	1,839	1,839
Distributions declared to Fund unitholders	6	-	(5,211)	(5,211)
Balance, June 30, 2017		<u>\$ 123,275</u>	<u>\$ (49,221)</u>	<u>\$ 74,054</u>
Balance, January 1, 2018		\$ 123,275	\$ (41,735)	\$ 81,540
Profit and comprehensive income for the period		-	16,100	16,100
Distributions declared to Fund unitholders	6	-	(5,370)	(5,370)
Balance, June 30, 2018		<u>\$ 123,275</u>	<u>\$ (31,005)</u>	<u>\$ 92,270</u>

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	Note	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Cash provided by (used for):					
OPERATIONS:					
Profit (loss) for the period		\$ 5,786	\$ (5,071)	\$ 16,100	\$ 1,839
Items not involving cash:					
Amortization of deferred financing charges		5	5	10	9
Deferred income tax expense (recovery)	8	(5)	1	(14)	50
Fair value loss (gain) on Exchangeable Partnership units	7	(2,620)	8,279	(9,545)	4,717
Distributions recorded as interest:					
Class C Partnership units		1,069	1,069	2,138	2,138
Exchangeable Partnership units		1,512	1,360	3,138	2,801
Changes in non-cash operating working capital:					
Royalty fee receivable from Keg Restaurants Ltd. .		57	5	385	321
Prepaid expenses and deposits		26	6	(34)	(53)
Accounts payable and accrued liabilities		(73)	(29)	26	(66)
Interest and financing fees		129	103	255	205
Interest income		(1,070)	(1,067)	(2,130)	(2,122)
Current income tax expense	8	1,143	1,092	2,363	2,251
Interest received		1,083	1,079	2,142	2,133
Income taxes paid	8	<u>(1,140)</u>	<u>(1,078)</u>	<u>(2,425)</u>	<u>(2,173)</u>
		5,902	5,754	12,409	12,050
FINANCING:					
Distributions paid to Class C unitholder		(1,069)	(1,069)	(2,138)	(2,138)
Distributions paid to Exchangeable unitholder		(1,526)	(1,361)	(3,245)	(2,834)
Distributions paid to Fund unitholders	6	(3,222)	(3,127)	(6,785)	(6,594)
Interest and financing fees paid		<u>(129)</u>	<u>(102)</u>	<u>(253)</u>	<u>(207)</u>
		<u>(5,946)</u>	<u>(5,659)</u>	<u>(12,421)</u>	<u>(11,773)</u>
Increase (decrease) in cash		(44)	95	(12)	277
Cash, beginning of period		<u>2,522</u>	<u>2,172</u>	<u>2,490</u>	<u>1,990</u>
Cash, end of period		<u>\$ 2,478</u>	<u>\$ 2,267</u>	<u>\$ 2,478</u>	<u>\$ 2,267</u>
Non-cash transactions:					
Increase in intangible assets on Royalty Pool net sales roll-in	5	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,915</u>	<u>\$ 2,742</u>

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

1. ORGANIZATION AND NATURE OF BUSINESS:

The Keg Royalties Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust established under the laws of Ontario, with the authority to issue an unlimited number of trust units and is governed by the Declaration of Trust signed May 31, 2002 and as amended on December 20, 2010. The Fund is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia.

The Fund was established to invest in The Keg Rights Limited Partnership (the “Partnership”), which owns the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the “Keg Rights”) used in connection with the operation of Keg steakhouse restaurants and bars.

The business of the Partnership is the ownership of the Keg Rights and through a Licence and Royalty Agreement (the “Licence and Royalty Agreement”) with Keg Restaurants Ltd. (“KRL”) to exploit the use of the Keg Rights and the collection of the royalty payable under the Licence and Royalty Agreement. KRL’s principal activity is the operation and franchising of Keg steakhouse and bar restaurants in Canada and the United States.

On January 23, 2018, Recipe Unlimited Corporation (“RECP”) (formerly Cara Operations Limited), KRL and the Fund announced that RECP and KRL agreed to merge pursuant to the terms of a binding letter of intent. On February 22, 2018, this transaction was completed but will not impact the operations of the Fund. The Fund will remain in its current form and will continue to receive royalty payments from Keg restaurants included in the Royalty Pool. There are no changes to the contractual relationships between the Fund, KRL and the Partnership arising out of the completion of the RECP and KRL merger.

2. BASIS OF PREPARATION:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”). These statements represent a condensed set of financial statements, and accordingly, do not include all of the information required for annual financial statements. These statements follow the same accounting policies and methods of their application as the most recent annual financial statements, except as described in note 2(c). These condensed consolidated interim financial statements should be read in conjunction with the Fund’s consolidated financial statements for the year ended December 31, 2017.

These condensed consolidated interim financial statements were authorized for issue by the Fund’s Board of Trustees on August 13, 2018.

(b) Functional and presentation currency:

These condensed consolidated interim financial statements have been prepared in Canadian dollars, which is also the Fund’s functional currency.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

2. BASIS OF PREPARATION (CONTINUED):

(c) New accounting standards:

Effective January 1, 2018, the Fund has adopted IFRS 9, *Financial Instruments* (“IFRS 9”) and IFRS 15, *Revenue from Contracts with Customers* (“IFRS 15”).

(i) IFRS 9, *Financial Instruments*:

On July 24, 2014, the International Accounting Standards Board (“IASB”) issued IFRS 9, *Financial Instruments*, and subsequently published amendments. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions.

IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

Classification and measurement of financial assets and financial liabilities:

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans, and receivables and available for sale.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost; fair value through other comprehensive income (“FVOCI”) – debt investment; or fair value in profit or loss. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. Financial liabilities are classified and measured on two categories: amortized costs or fair value through profit or loss (“FVTPL”). Derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

The following table and the accompanying notes below explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Fund’s financial assets and liabilities. The adoption of the new classification requirements under IFRS 9 did not result in any changes in measurement or the carrying amount of financial assets and liabilities.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

2. BASIS OF PREPARATION (CONTINUED):

(c) New accounting standards (continued):

(i) IFRS 9, *Financial Instruments* (continued):

Classification and measurement of financial assets and financial liabilities (continued):

Financial Asset / Liability	Classification under IAS 39	Classification under IFRS 9
Cash	Loans and receivables	Amortized cost
Royalty fee receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Interest on note receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Note receivable from Keg Restaurants Ltd.	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Interest payable on term loan	Other financial liabilities	Amortized cost
Distributions payable to Fund unitholders	Other financial liabilities	Amortized cost
Distributions payable to Keg Restaurants Ltd.	Other financial liabilities	Amortized cost
Term loan, net of deferred financing charges	Other financial liabilities	Amortized cost
Class C partnership units	Other financial liabilities	Amortized cost
Exchangeable Partnership units	FVTPL	FVTPL

Impairment of financial assets:

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ (“ECL”) model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Under IFRS 9 credit losses are recognized earlier than under IAS 39.

Financial assets measured at amortized cost are assessed at each reporting date to determine the credit risk of the financial asset to apply the relevant impairment requirements. There are generally 3 stages of credit risk:

1. Financial assets that are expected to perform in line with their contractual terms and which have no signs of increased credit risk;
2. Financial assets that have significantly increased in credit risk since initial recognition but are not credit-impaired; and
3. Credit-impaired financial instruments.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

2. BASIS OF PREPARATION (CONTINUED):

(c) New accounting standards (continued):

(i) IFRS 9, *Financial Instruments* (continued):

Impairment of financial assets (continued):

A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Fund on terms that the Fund would not consider otherwise, or indications that a debtor or issuer will enter bankruptcy.

The Fund considers evidence of impairment of financial assets measured at amortized cost at both a specific asset and collective level. All individually significant financial assets measured at amortized cost are assessed for specific impairment. All individually significant financial assets measured at amortized cost found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Such assets that are not individually significant are collectively assessed for impairment by grouping together financial assets measured at amortized cost with similar risk characteristics.

An impairment loss in respect of a financial asset measured at amortized cost is measured through a loss allowance at an amount equal to:

- 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and
- Lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

Losses are recognized in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through comprehensive income.

Derivative financial instruments:

The requirement of the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative financial instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

Aside from classification, the impact of adopting IFRS 9 has had no material impact on measurement of the Fund's financial assets or liabilities.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

2. BASIS OF PREPARATION (CONTINUED):

(c) New accounting standards (continued):

(ii) IFRS 15, *Revenue from Contracts with Customers*:

On May 28, 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*. IFRS 15 replaces IAS 18, *Revenue* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services. This is achieved by applying the following five steps:

1. identify the contract with a customer;
2. identify the performance obligations in the contract;
3. determine the transaction price;
4. allocate the transaction price to the performance obligations in the contract; and
5. recognize revenue when (or as) the entity satisfies a performance obligation.

Revenue recognition under a lease commences when the tenant has a right to use the leased assets. Generally, this occurs on the lease inception date or, when the Fund is required to make additions to the property in the form of tenant improvements which enhances the value of the property, when substantially complete. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease. A straight-line rent receivable is included in the carrying amount.

There was no significant impact on the Fund's financial statements or business as a result of the adoption of this new standard.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit and per unit amounts - unaudited)

For the three and six months ended June 30, 2018 and 2017

3. EARNINGS PER UNIT:

Basic earnings per unit calculations are based on the weighted average number of Fund units outstanding during the period. Diluted earnings per unit calculations are based on the weighted average number of Fund units and Exchangeable Partnership units outstanding during the period.

Diluted earnings per unit includes the Exchangeable Partnership units and is calculated by adjusting the weighted average number of Fund units outstanding to assume conversion of all potentially dilutive Fund units. For the purposes of the weighted average number of units outstanding, units are determined to be outstanding from the date they are issued and adjusted to be effective January 1 of each year on December 31 when the actual full-year performance of the new restaurants is known with certainty.

The following reconciles the basic profit (loss) to the diluted profit:

	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Profit (loss) for the period	\$ 5,786	\$ (5,071)	\$ 16,100	\$ 1,839
Distributions on Exchangeable Partnership units	1,512	1,360	3,138	2,801
Increase in current income tax expense	(408)	(354)	(847)	(728)
Fair value loss (gain) on Exchangeable Partnership units	<u>(2,620)</u>	<u>8,279</u>	<u>(9,545)</u>	<u>4,717</u>
Diluted profit for the period	<u>\$ 4,270</u>	<u>\$ 4,214</u>	<u>\$ 8,846</u>	<u>\$ 8,629</u>
Weighted average number of:				
Fund units	11,353,500	11,353,500	11,353,500	11,353,500
Exchangeable Partnership units	<u>4,030,068</u>	<u>3,599,814</u>	<u>4,030,068</u>	<u>3,599,814</u>
Weighted average number of units	<u>15,383,568</u>	<u>14,953,314</u>	<u>15,383,568</u>	<u>14,953,314</u>
Basic earnings (loss) per Fund unit	<u>\$ 0.51</u>	<u>\$ (0.45)</u>	<u>\$ 1.42</u>	<u>\$ 0.16</u>
Diluted earnings (loss) per Fund unit	<u>\$ 0.28</u>	<u>\$ (0.45)</u>	<u>\$ 0.58</u>	<u>\$ 0.16</u>

For the three and six months ended June 30, 2017, the Exchangeable Partnership units are anti-dilutive. Accordingly, the fully diluted earnings (loss) per Fund unit equals the basic earnings per Fund unit for these periods.

4. ROYALTY POOL:

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in a specific royalty pool (the "Royalty Pool") plus a make-whole payment, if required by a restaurant closure, based on four percent of lost system sales. System sales for any period and for any Keg restaurant located in Canada and the United States, as defined in the Licence and Royalty Agreement, means the gross sales by such Keg restaurants for such period.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except number of restaurants - unaudited)

For the three and six months ended June 30, 2018 and 2017

4. ROYALTY POOL (CONTINUED):

On January 1, 2018, an estimated \$20,159,000 in annual net sales were added to the Royalty Pool. Five new restaurants that opened during the period from October 3, 2016 through October 2, 2017, with estimated gross sales of \$28,250,000 annually, were added to the Royalty Pool. Two permanently closed restaurants with annual sales of \$8,091,000 were removed from the Royalty Pool. The total number of restaurants in the Royalty Pool increased to 103. The pre-tax yield of the Fund units was determined to be 7.54% calculated using a weighted average unit price of \$20.28.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 487,765 Fund units, being 3.15% of the Fund units on a fully diluted basis.

On January 1, 2018, KRL received 80% of this entitlement, representing the equivalent of 390,212 Fund units, being 2.54% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 4,030,068 Fund units, representing 26.20% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted on December 31, 2018, to be effective January 1, 2018, once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2018, it would have the right to exchange its Partnership units for 4,127,621 Fund units, representing 26.66% of the Fund units on a fully diluted basis.

There was one restaurant closure from January 1 to June 30, 2018 that required a make-whole payment (January 1 to June 30, 2017 – two permanent restaurant closures).

Two new corporate and one new franchised restaurant were opened subsequent to October 2, 2017 and will be added to the Royalty Pool on January 1, 2019. Royalty income was calculated as follows:

	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Restaurants in Royalty Pool	103	100	103	100
Royalty Pool system sales	\$ <u>150,974</u>	\$ <u>145,472</u>	\$ <u>312,937</u>	\$ <u>299,532</u>
Royalty income at 4% of system sales reported above	6,039	5,819	12,518	11,981
Make-whole payment, based on 4% of lost system sales	<u>5</u>	<u>50</u>	<u>5</u>	<u>94</u>
Total royalty income	\$ <u>6,044</u>	\$ <u>5,869</u>	\$ <u>12,523</u>	\$ <u>12,075</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit and per unit amounts - unaudited)

For the three and six months ended June 30, 2018 and 2017

5. INTANGIBLE ASSETS:

On May 31, 2002, the Partnership acquired the Keg Rights from KRL for \$113,546,820 of which \$30,487,380 was paid in cash, \$9,059,440 was paid by the issuance of 905,944 Class A Partnership units (“Class A Units”), \$17,000,000 was paid by the issuance of 3,376,700 Class B Partnership units (“Class B units”) and \$57,000,000 was paid by the issuance of 5,700,000 Class C units (“Class C units”). Concurrent with the sale of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a period of 99 years. As consideration, KRL pays the Partnership a royalty of four percent of system sales reported by the Keg restaurants included the Royalty Pool (note 4).

The Fund has adopted a policy of accounting for the Additional Entitlement of Class B and Class D Partnership units (Class D units”) based on the fair value of these units at the date of determination which results in an increase in intangible assets and in the Exchangeable Partnership unit liability. The value of the Keg Rights increased by \$7,915,000 as a result of the January 1, 2018 Additional Entitlement (2017 Additional Entitlement – \$3,575,000).

6. DISTRIBUTIONS ON FUND UNITS:

	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Distributions declared to Fund unitholders	\$ <u>3,222</u>	\$ <u>3,127</u>	\$ <u>5,370</u>	\$ <u>5,211</u>
Weighted average Fund units outstanding	<u>11,353,500</u>	<u>11,353,500</u>	<u>11,353,500</u>	<u>11,353,500</u>
Distributions declared per unit	\$ <u>0.28</u>	\$ <u>0.28</u>	\$ <u>0.47</u>	\$ <u>0.46</u>

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters and four distributions in the fourth quarter. This is done to ensure that the distribution based on December KRL Royalty Pool system sales, which is paid the following month in January, is recorded in the period it was earned for income tax purposes. The determination to declare and make payable distributions from the Fund are at the discretion of the Board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund unitholders.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit amounts - unaudited)

For the three and six months ended June 30, 2018 and 2017

7. EXCHANGEABLE PARTNERSHIP UNITS:

KRL has the following Exchangeable Partnership units that are exchangeable into Fund units:

	June 30, <u>2018</u>	<u>Fair Value</u>
Class A Partnership units	905,944	\$ 15,990
Class B Partnership units	176,700	3,119
Class D Partnership units	<u>2,947,424</u>	<u>52,022</u>
	<u>4,030,068</u>	<u>\$ 71,131</u>
	December 31, <u>2017</u>	<u>Fair Value</u>
Class A Partnership units	905,944	\$ 18,110
Class B Partnership units	176,700	3,532
Class D Partnership units	<u>2,557,212</u>	<u>51,119</u>
	<u>3,639,856</u>	<u>\$ 72,761</u>

The Exchangeable Partnership units are presented in the Fund's financial statements as a financial liability and measured at fair value. Changes in fair value are recognized in profit or loss in the period in which they occur. The fair value of the Exchangeable Partnership units is determined by using Level 2 inputs being the closing market price of the Fund units on the Toronto Stock Exchange ("TSX") at the respective reporting date as Exchangeable Partnership units have similar distribution and voting rights as the Fund units. The closing unit price as at June 30, 2018 was \$17.65 (December 31, 2017 – \$19.99).

The components of the change in balances in the Exchangeable Partnership unit liability for the three-month periods are as follows:

	Total number of Exchangeable Partnership units	<u>Fair Value</u>
Exchangeable Partnership units, January 1, 2018	3,639,856	\$ 72,761
January 1 initial estimate of Class D unit entitlement (80%)	390,212	7,915
Fair value adjustment	<u>-</u>	<u>(9,545)</u>
Fair value of Exchangeable Partnership units, June 30, 2018	<u>4,030,068</u>	<u>\$ 71,131</u>
	Total number of Exchangeable Partnership units	<u>Fair Value</u>
Exchangeable Partnership units, January 1, 2017	3,468,091	\$ 73,177
January 1 initial estimate of Class D unit entitlement (80%)	131,723	2,742
Fair value adjustment	<u>-</u>	<u>4,717</u>
Fair value of Exchangeable Partnership units, June 30, 2017	<u>3,599,814</u>	<u>\$ 80,636</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

7. EXCHANGEABLE PARTNERSHIP UNITS (CONTINUED):

Pursuant to the declaration of trust, the holders (other than the Fund or its subsidiaries) of the Class A units, Class B units and Class D units are entitled to vote in all votes of Fund unitholders as if they were holders of the number of Fund units they would receive if Class A, entitled Class B and Class D units were exchanged into Fund units as of the record date of such votes, and will be treated in all respects as Fund unitholders for the purpose of any such votes.

- (i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C units, multiplied by the number of Class A units divided by the number of LP Partnership units (“LP units”) issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at June 30, 2018. In addition, the Class A units receive a residual distribution proportionately with the Class B units, Class D units, LP units and general partnership units (“GP units”) relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Class A unit for one Fund unit and represent KRL’s initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.
- (ii) The Class B units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class B units were adjusted annually on January 1 until the January 1, 2008 roll-in when the Class B Termination Date was reached and the last of the Class B units became entitled. Class B units held by KRL are exchangeable for Fund units on the basis of one Class B unit for one Fund unit. Class B units held by KRL receive a distribution entitlement.
- (iii) The Class D units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class D units are adjusted annually on January 1. Class D units held by KRL are exchangeable for Fund units on the basis of one Class D unit for one Fund unit and receive the same distribution entitlement as the Class B units.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

8. INCOME TAXES:

The Fund is subject to tax at a rate of 27.0% for the 2018 and later taxation years (26.0% for 2017).

The components of income tax expense are as follows:

	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Current income tax expense	\$ (1,143)	\$ (1,092)	\$ (2,363)	\$ (2,251)
Deferred income tax recovery (expense)	<u>5</u>	<u>(1)</u>	<u>14</u>	<u>(50)</u>
	<u>\$ (1,138)</u>	<u>\$ (1,093)</u>	<u>\$ (2,349)</u>	<u>\$ (2,301)</u>

During the six months ended June 30, 2018, the Fund made cash income tax instalment payments of \$2,238,000 (six months ended June 30, 2017 – \$2,173,000). Management estimates the Fund's current income tax expense for each reporting period based on actual results and adjusts current income tax expense accordingly. Instalment payments required by the Canada Revenue Agency are an estimate based on prior year's results. As a result, the Fund has an estimated \$116,000 income tax payable as at June 30, 2018 (December 31, 2017 – \$178,000).

Total cash income taxes paid during the respective periods are as follows:

	April 1 to June 30, <u>2018</u>	April 1 to June 30, <u>2017</u>	January 1 to June 30, <u>2018</u>	January 1 to June 30, <u>2017</u>
Income tax instalment payments related to the current fiscal year	\$ (1,140)	\$ (1,078)	\$ (2,238)	\$ (2,173)
Income tax payment related to balance owing from the prior fiscal year	<u>-</u>	<u>-</u>	<u>(187)</u>	<u>-</u>
	<u>\$ (1,140)</u>	<u>\$ (1,078)</u>	<u>\$ (2,425)</u>	<u>\$ (2,173)</u>

The balance of the Fund's deferred income tax liability decreased to \$2,410,000 as at June 30, 2018 (December 31, 2017 – \$2,424,000). The deferred tax liability arises mainly as a result of the Fund recording, in the current period, its cumulative share of the temporary differences between the accounting and tax bases of the Keg Rights, owned by the Partnership, generated since inception of the Fund.

The tax effect of the temporary difference that gives rise to the deferred tax liability is as follows:

	June 30, <u>2018</u>	December 31, <u>2017</u>
Deferred income tax liability:		
Temporary difference related to the Keg Rights	\$ 2,410	\$ 2,424
Deferred income tax liability	<u>\$ 2,410</u>	<u>\$ 2,424</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

9. RELATED PARTY TRANSACTIONS AND BALANCES:

KRL is considered to be a related party of the Fund by virtue of common directors of KRL and The Keg GP Ltd. (“KGP”), the General Partner of the Partnership and Administrator of the Fund. The Fund has entered into an administrative agreement with its subsidiary, the Partnership, whereby the Partnership will provide, or arrange for the provision of, services required in the administration of the Fund. In turn, the Partnership has arranged for certain of these services to be provided by KRL in its capacity as a partner of the Partnership. KRL provided these services at no cost to the Partnership or the Fund.

The following is a summary of the balances due to and due from KRL:

	June 30, <u>2018</u>	December 31, <u>2017</u>
Royalty fee, including GST/HST	\$ 2,478	\$ 2,863
Interest on note receivable from KRL	<u>351</u>	<u>363</u>
Due from KRL	<u>\$ 2,829</u>	<u>\$ 3,226</u>

The above amounts were received from KRL when due, subsequent to the end of the above periods to facilitate the following month’s distribution to Fund unitholders.

	June 30, <u>2018</u>	December 31, <u>2017</u>
Distribution payable to KRL	<u>\$ 951</u>	<u>\$ 1,058</u>

The above amounts were paid to KRL when due, subsequent to the end of the periods above.

10. FINANCIAL INSTRUMENTS:

The Fund must classify fair value measurements according to a hierarchy that reflects the significance of the inputs used in performing such measurements. The Fund’s fair value hierarchy comprises the following levels:

- Level 1 – quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – pricing inputs are other than quoted in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – valuations in this level are those with inputs for the asset or liability that are not based on observable data.

The fair value of the Exchangeable Partnership unit liability is determined using Level 2 inputs, and measured on a recurring basis.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and six months ended June 30, 2018 and 2017

10. FINANCIAL INSTRUMENTS (CONTINUED):

The following table presents the carrying amounts of each category of financial assets and liabilities:

	June 30, <u>2018</u>	December 31, <u>2017</u>
Financial assets:		
Amortized cost:		
Cash	\$ 2,478	\$ 2,490
Royalty fee receivable from Keg Restaurants Ltd.	2,478	2,863
Interest on note receivable from Keg Restaurants Ltd.	351	363
Note receivable from Keg Restaurants Ltd.	<u>57,000</u>	<u>57,000</u>
	<u>\$ 62,307</u>	<u>\$ 62,716</u>
Financial liabilities:		
Amortized cost:		
Accounts payable and accrued liabilities	\$ 333	\$ 307
Interest payable on term loan	43	41
Distributions payable to Fund unitholders	-	1,415
Distributions payable to Keg Restaurants Ltd.	951	1,058
Term loan, net of deferred financing charges	13,957	13,947
Class C Partnership units	57,000	57,000
Fair value through profit or loss:		
Exchangeable Partnership units	<u>71,131</u>	<u>72,761</u>
	<u>\$ 143,415</u>	<u>\$ 146,529</u>